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Why charity is selfish

A good time for a squeeze

The benefits of tighter credit

PRINT EDITION

Full contents | Subscribe
Enlarge current cover
Past issues/regional covers

NEWS ANALYSIS
POLITICS THIS WEEK
BUSINESS THIS WEEK
OPINION
Leaders
Letters to the editor
Blogs
Columns
Kallery

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
International
Country Briefings Go
Cities Guide Go

SPECIAL REPORTS
BUSINESS
Management
Business Education
FINANCE & ECONOMICS
Economics Focus
Economics A-Z
SCIENCE & TECHNOLOGY
Technology Quarterly
BOOKS & ARTS
Style Guide
PEOPLE
Obituary
MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index
Chart Gallery
DIVERSIONS
Correspondent's Diary
RESEARCH TOOLS
AUDIO
DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds
Screensaver
CLASSIFIED ADS
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Print Edition August 4th 2007

On the cover
Tighter credit conditions are just what the markets need: leader

Previous print editions
Jul 28th 2007
Jul 21st 2007
Jul 14th 2007
Jul 7th 2007
Jun 30th 2007
More print editions and covers »

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The world this week

Politics this week
Business this week
KAL's cartoon

Leaders

Market turmoil
A good time for a squeeze

Darfur
No time to take the pressure off

Upper-house elections in Japan
The humiliation of Shinzo Abe

America, India and the China bogey
A price too high

Nigeria
Mission impossible, nearly

Letters

On Turkey, accountancy, Hong Kong, narrowcasting, Sark, the Tour de France

Briefing

China's military might
The long march to be a superpower

United States

Political corruption
Investigating Alaska

Race relations
Where black and brown collide

City gangs
Living with cockroaches

Alberto Gonzales
A visit to the hospital

Student lending
Fair sailing for young scholars

Illegal immigration
A Haven indeed

Troubled Republicans
Of seals and Newts

Lexington
Gotcha!

Correction: Sinclair Broadcast Group

The Americas

Haiti
A small success for the UN

Colombia's peace process
Demob unhappy

Cuba
Conceptual change

Brazil
Fight in the favelas

Corrections: Panama and Brazil

Asia

Japan
Keeping his head just above water

ASEAN
Past it at 40?

The Khmer Rouge trials
Better late than never

Korean Christians and the Taliban
A clash of faiths

Bollywood baddies

Business

Emissions trading
Lightly carbonated

Media
Rupert gets his trophy

Deutsche Bahn
Summer of discontent

Business in China
Dirty dealing

Marketing to Muslims
Food, fashion and faith

Cross-border shopping
You'd be a loonie not to

Face value
The nimble sumo

Briefing

The credit squeeze
Abandon ship

The effect on financial firms
Holiday horrors

Finance & Economics

Tax reform
Overhauling the old jalopy

Hedge funds
All locked-up

Buttonwood
Cold Turkey

Catastrophe bonds
Ports and storms

China's economy
Be careful what you wish for

Economics focus
In praise of usury

Science & Technology

Evolutionary psychology
Blatant benevolence and conspicuous consumption

Neuroscience and genetics
Lest we forget or lest we remember?

Medicine
No-iron rations

Materials science
Opal fruits

Books & Arts

Latin America
Man and superman

The Reformation
In pursuit of the old and pure

How to help the poorest
Springing the traps

Art in Myanmar
A prisoner's tale

Filming German history
The good German

Saudi fiction
But love's a malady without a cure

Obituary

Ingmar Bergman

Take Dutt

Middle East & Africa

America in the Middle East
Arming its friends and talking peace

Iraq
A winning goal, then back to war

Conserving Damascus
A road that is not straight

Punishing apartheid's crimes
If it happened it wasn't me

Sierra Leone
As you were

Eritrea
Nice new friends

Advertisement

Europe

Energy in Germany
Nuclear fallout

Terrorism in Spain
A winning streak for Zapatero

Political scandals in Italy
Courting trouble

After Turkey's election
General displeasure

Charlemagne
Smoke gets in their eyes

Correction: Italian pensions

Britain

Innovation and the economy
The good, the bad and the ugly

GDP redefined
Intangible measures

BA and Virgin
Flying in formation

The de Menezes shooting
In the aftermath

Birth certificates
Misconceived

Retail banking
Once more unto the branch

Immigrants and Britishness
Stirring the melting pot

Drug prescribing
Trial of strength

Bagehot
Doublespeak

Correction: Flooding in Britain

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International

Non-violent protest
They shall overcome—but perhaps not always

Football for the homeless
Who says it's only a game?

Economic and Financial Indicators

Overview

Output, prices and jobs

The Economist commodity-price index

Productivity

Trade, exchange rates, budget balances and interest rates

Markets

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Politics this week

Aug 2nd 2007
From The Economist print edition

Getty Images

Japan's voters delivered a humiliating verdict on the government of Shinzo Abe, the prime minister, and his Liberal Democratic Party. For the first time the LDP is not the biggest party in the upper house of the Diet (parliament) after an election in which half the seats were contested. However, the LDP still enjoys a big majority in the lower house, and Mr Abe resisted calls to resign. See article

Pakistan's president, General Pervez Musharraf, was reported to have met Benazir Bhutto, an exiled former prime minister, for talks about a political accommodation. Ms Bhutto insists General Musharraf must stand down from the army if he is to stay on as president.

Sanjay Dutt, a leading **Bollywood** actor, was sentenced to six years in jail for having procured weapons from gangsters involved in a series of bombings in Mumbai in 1993, which killed almost 260 people. See article

In **Cambodia** a United Nations-backed tribunal into abuses perpetrated by the Khmer Rouge regime of 1975-78 filed its first charges. Kang Kek Ieu, alias Duch, who ran the notorious Tuol Sleng torture centre in Phnom Penh, was indicted for crimes against humanity. See article

There was anguish in South Korea over the plight of a 23-strong group of Christians, including 18 women, held hostage by the Taliban in **Afghanistan** after the group's pastor and one other were killed. The hostage-takers are demanding the release of Taliban prisoners held by the Afghan and American governments. See article

Territorial expansion?

Russia dispatched an expedition to lay symbolic claim to part of the **Arctic** seabed. It plans to send two mini-submarines under the North Pole to scoop samples and deposit the Russian flag. Under international law five countries lying partly in the Arctic Circle—Russia, the United States, Canada, Norway and Denmark—are limited to a 200 mile (320km) economic zone from their shores. Russia claims a larger slice, saying its continental shelf extends from Siberia to the North Pole.

Despite a resounding victory for the mildly Islamist Justice and Development (AK) Party in the recent elections, **Turkey's** chief of staff, General Yasar Buyukanit, said there was no change in the army's insistence that the country's next president should uphold the country's secular values. His comments came as the foreign minister, Abdullah Gul, a leading AK member, appeared ready to make another presidential bid. See article

Several **German** politicians criticised the French offer to build a nuclear-power reactor for Libya, expressing concern about France's hyperactive “go-it-alone” diplomacy and doubts about the trustworthiness of Muammar Qaddafi.

The British army officially ended Operation Banner in **Northern Ireland**, its longest continuous operation. Soldiers were sent to the province in 1969 in what was intended to be a brief stint to quell sectarian violence. A garrison of 5,000 men will remain to offer support to the police.

Firm allies

Gordon Brown visited **George Bush** at Camp David, where the pair held their first summit since Mr Brown became Britain's prime minister. In contrast to his predecessor, Mr Brown subtly distanced himself from the president, but he also reaffirmed that Britain and America were “at one” when it came to

fighting terrorism and had “responsibilities to keep” in Iraq. See article

Alberto Gonzales, America's beleaguered attorney-general, was in the spotlight again. Four Democratic senators called for an investigation into whether Mr Gonzales was telling the truth at a recent hearing about administration discussions on Mr Bush's secret wiretapping programme. See article

The FBI widened its investigation into political corruption involving an energy-services company in **Alaska** when it searched the home of Ted Stevens, the longest serving Republican senator. Mr Stevens, who took office in 1968, urged his constituents not to draw any conclusions until the investigation is complete. See article

A section of a bridge over the Mississippi river in **Minneapolis** collapsed during the evening rush hour. Several people were killed and scores injured as vehicles plunged into the waters below. The bridge was undergoing light repair work.

AP

Peaceful means

In an effort to keep alive a stumbling peace process, **Colombia's** government sent a bill to Congress to allow demobilised right-wing paramilitaries to be pardoned. The Supreme Court had earlier ruled out pardons because their crimes were not political. See article

A year after he handed over power in **Cuba** to his brother Raúl and underwent intestinal surgery, Fidel Castro wrote in a newspaper article that he continued to be consulted about all important decisions. However, he took no part in official celebrations marking the anniversary of the start of his communist revolution, where Raúl Castro called for “structural and conceptual changes” to Cuba's economy. See article

Better late than never

AFP

The United Nations Security Council voted to send a peacekeeping force of up to 26,000 soldiers and police to the **Darfur** region of Sudan, where at least 200,000 people have been killed and about 2.5m made homeless since 2003. The Sudanese government, which disputes those numbers and insists that most of the region is at peace, has long resisted having any UN troops in Darfur. See article

In **Iraq**, at least 67 people were killed and 100 wounded in two separate vehicle bombings in Baghdad on August 1st. Meanwhile, the main Sunni political block, the Iraqi Consensus Front, withdrew from the government, saying that the Shia-led administration had failed to fulfil several pledges, such as stronger action against the Shia militias.

Condoleezza Rice, America's secretary of state, and Robert Gates, its defence secretary, visited the Middle East as the United States said it would provide its allies with more than **$60 billion worth of arms** over the coming decade. See article

The government of **Zimbabwe** began circulating a 200,000 Zimbabwean dollar note so that people will be able to cope better with the country's runaway inflation. The note will buy about 1kg (2.2lbs) of sugar—if there is any left in the shops after a recent wave of panic buying.

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Business this week

Aug 2nd 2007
From The Economist print edition

The fallout from the **credit squeeze** continued to reverberate. After a heavy drubbing at the end of the previous week, stockmarkets fell again, with the share prices of firms thought to be at most risk faring badly. The credit woes spread to Germany's banking system. IKB Deutsche Industriebank, a mid-sized lender, is being bailed out by a group of German banks after admitting to steep losses stemming from its exposure to America's subprime mortgage market. See article

Cadbury Schweppes extended the bidding period for its North American drinks division, which has attracted the interest of private-equity firms, citing “extreme volatility” in the markets.

Family fortunes

Rupert Murdoch claimed victory in his $5 billion bid for **Dow Jones** when enough members of a divided Bancroft family, which has controlled the company since 1902, voted in favour of the deal. The publisher of the *Wall Street Journal* will become part of Mr Murdoch's News Corporation group after all shareholders have voted. See article

Mr Murdoch's **BSkyB**, a British subscription-based TV company, agreed to buy **Amstrad**, which makes some of its set-top boxes. Amstrad is run by Sir Alan Sugar, the star of the British version of “The Apprentice”. He will now report to Mr Murdoch's son, James.

Mattel issued a safety recall for 1.5m of its Fisher-Price **toys** (1m of which are in America) because they may contain hazardous levels of lead paint. It is the latest scare involving Chinese-made goods.

A first estimate by the Commerce Department reported that **America's economy** grew by 3.4% at an annual rate in the second quarter, its best performance since the first three months of 2006. Separately, American **consumer confidence** reached a six-year high in July, according to one widely tracked measure.

Nonetheless, carmakers in the United States saw their weakest sales for years in July. Sales at **General Motors** and **Ford** plunged by 22% and 19% respectively compared with July 2006. Even **Toyota**, on course to overtake GM as the world's biggest carmaker, saw sales drop. The news overshadowed strong earnings from GM, which made a second-quarter net profit of $891m on the back of sales outside America. Last week **Ford** posted a profit of $750m.

Fuelish things

British Airways was fined £270m ($546m) by authorities in America and Britain for trying to fix fuel surcharges. The airline admitted wrongdoing in an investigation that was launched after Virgin Atlantic, BA's arch-rival, blew the whistle about the collusion, giving it immunity in the case. See article

Alitalia postponed a decision about its future until the end of August. A seven-month auction conducted by Italy's government to sell the loss-making national carrier collapsed when the last of the prospective buyers pulled out. The bidders had criticised the stringent conditions attached to a sale.

Verizon Wireless said it would buy **Rural Cellular** for $2.7 billion in order to reduce the roaming expenses it incurs when subscribers wander out of range and it pays other carriers to transmit their calls.

In the biggest foreign acquisition by a South Korean firm, **Doosan Infracore** agreed to buy three construction-equipment units from American conglomerate **Ingersoll-Rand** for $4.9 billion.

Resolution's plan to merge with fellow British life-insurer **Friends Provident** was criticised by Pearl Assurance, a rival which has increased its stake in Resolution to around 16%. Resolution indicated it

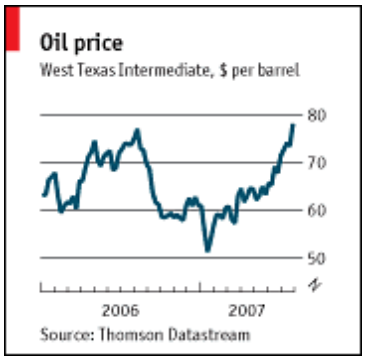
would, if necessary, restructure the deal to allow a lower threshold required for shareholders to agree.

The president of one of Russia's biggest privately held oil firms resigned, citing “bullying” by the state. Mikhail Gutseriyev, who formed **RussNeft** in 2002, has been served with several tax claims. Last week, the holding company controlled by Oleg Deripaska, one of Russia's tycoon oligarchs and a Kremlin loyalist, applied to Russia's anti-monopoly service for a stake in RussNeft.

America's **Marathon Oil** offered to buy Canada's **Western Oil Sands** for around $6.2 billion. Marathon now gains access to the 174 billion barrels of oil that it is thought can be recovered profitably from Canada's oil sands.

High energy

The **price of oil** reached a record high. The markets remained jittery after crude-oil inventories in the United States fell by more than expected. Tighter supply in America is one of the reasons why the price of West Texas Intermediate has risen above the price of London Brent over the past week.



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KAL's cartoon

Aug 2nd 2007
From The Economist print edition

Kevin Kallaugher

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Market turmoil

A good time for a squeeze

Aug 2nd 2007
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Tighter credit conditions are just what the markets need

Aidan Potts

BANKERS and investors might not agree, but the recent sell-off in financial markets is good news. It may, at last, have brought people to their senses. For the past few years, too much money has been lent too cheaply and too easily to too many people, whether it was speculators trying to make a fast buck in Miami condominiums or private-equity groups financing their latest multi-billion-dollar takeover. This wake-up call came too late to save the American housing market from frenzy and subsequent bust. But it may have arrived in time to stop the takeover boom getting out of control—and when the world economy is strong enough to cope with the consequences.

Watch out for the American consumer

The big question now is how serious those consequences are likely to be. The impact on debt markets themselves will be big (see article). As standards are tightened, many of the reckless practices that have become the norm in corporate lending will be abandoned. We will now hear a lot less about firms getting "covenant lite" loans, under which lenders give up their rights to monitor the behaviour of borrowers; or "payment-in-kind notes", which allow borrowers to substitute more IOUs for interest payments. As investors steer clear of riskier debt, the takeover bids that have pumped this year's stockmarket froth will be curtailed and the most debt-laden borrowers may find it impossible to raise funds.

But most companies will be able to shrug off the credit squeeze. That is partly because creditworthy borrowers still have access to debt (albeit at a higher price), and partly because many firms don't have to borrow. Across the rich world, firms are flush with cash. Their profits have been fat for the past five years and, on average, companies have been funding their capital spending from their own resources. Credit wobbles by themselves, therefore, need not prompt an investment slump.

Other potential victims also seem well-prepared. Emerging-market bonds and shares, for instance, may jitter further. That could spell trouble for a few countries, such as Turkey, which have large current-account deficits (see article). But most emerging markets are in far better shape than they were during the financial crises of the late 1990s. They have restructured their borrowing and often built up vast coffers of foreign-exchange reserves.

The biggest risk to the global economy probably lies with debt-laden American consumers. They have been battered by falling house prices and expensive petrol, and their spending growth has already slowed sharply. A credit squeeze will aggravate the housing bust and falling house prices could drag spending

down further. But the rest of the world is growing strongly and unemployment in America remains low, so a recession there is by no means inevitable. What's more, if the economy were to head downhill fast, the Fed, despite its public worries about inflation, has plenty of scope for cutting interest rates.

All told, the credit wobbles so far are likely to have only modest economic consequences. But what if they prompt a broader market meltdown? After all, many of the newfangled instruments that dominate today's debt markets have never been tested in a serious panic. Credit derivatives have probably improved the stability of the global economy by dispersing risk, but it is no longer clear where that risk is being held. And many of the new risk-dispersing instruments are so illiquid that trouble may not emerge for some time. It was several months after the subprime mortgage market turned sour before the scale of the losses at two Bear Stearns hedge funds became clear.

Investors are right to worry about more hedge-fund failures. Yet although these highly leveraged creatures seem to have made credit tremors more sudden and more frequent, these episodes have not been more calamitous. The past 18 months have seen two other credit wobbles, albeit on a smaller scale: one in May 2006 when investors worried about inflation; another in February this year, when fears about subprime mortgages first surfaced. In each case, the most exposed hedge funds had to cut their positions quickly. But thanks to the size and diversity of the hedge-fund industry, others moved in to buy the assets cheaply. The same dynamic seems to be playing out this time too (see article).

For all the hand-wringing about hedge funds and complicated derivatives, the real worry comes from a well-known source—the banks. They will face trouble on several fronts and it is they who could turn a healthy credit squeeze into a nasty crunch. Many banks have already agreed to underwrite deals and are finding that they cannot sell the debt on to investors. One estimate suggests that more than $300 billion of debt is already in the pipeline. Big losses could follow.

Banks will also suffer from their exposure to failed hedge funds, just as some have already been hit by their exposure to the subprime mortgage market. Some banks may have as-yet-undisclosed losses on their own accounts: trading in financial markets has become an increasingly important source of their profits in recent years. If banks' profits collapsed, they would become more reluctant to lend. A bank failure (or the fear thereof) could create a systemic panic.

A plump cushion

Yet although banks are the biggest worry, their balance sheets look fairly solid. America's commercial banks bought back $58 billion-worth of their shares in the year to March, suggesting they have capital to spare. And although banks' shares have tumbled over the past few weeks, analysts are still forecasting higher profits for the year ahead. If the solidity of bank finances is to be tested, the markets have chosen a good time to do so.

Credit cycles are unpredictable creatures. Things could still go badly wrong. So far, though, the financial wobbles, however unnerving, look like a healthy repricing of risk. Markets, much like people, sometimes need a good squeeze.

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Darfur

No time to take the pressure off

Aug 2nd 2007
From The Economist print edition

The proposed UN force is a sweet and sour deal for desperate Darfuris

AFP

Get article background

THE passing of a United Nations resolution on July 31st to deploy up to 26,000 troops and police in Darfur is a welcome diplomatic breakthrough in trying to end the conflict there. At least 200,000 people have been killed and about 2.5m displaced since hostilities broke out in 2003 in Sudan's western region. The UN, led by America, Britain and France on the Security Council, had been pushing an extremely reluctant Sudanese government into accepting such a force for over a year, so it is a victory for relentless diplomatic pressure. Bouquets, then, to the Western trio for keeping at it.

It is the Chinese, however, who have really made this possible. As the buyer of most of Sudan's oil, China has always been the key to imposing real pressure on its murdering government. For years it did nothing, reasoning that the best way to protect its commercial interests was to indulge the wishes of the regime in Khartoum. But in the past few months, the message from Beijing has changed. The Chinese seem increasingly to have accepted some of the moral and political responsibilities that come with their new economic clout. And, with threats of boycotts over Darfur ringing in their ears, they might also have had the 2008 Beijing Olympics in mind when they voted for the new resolution on July 31st.

This about-turn is extremely welcome. However, a paper resolution passed in New York will not on its own bring a solution to Darfur's problems any nearer. In many ways, the really difficult work begins now.

For a start, the UN needs to find the troops and police for this mission, which will be the largest of its kind. Sudan insists that most of them should be African, but the impoverished African Union (AU) is finding it hard to raise just 8,000 troops for Somalia. And with a UN force of 17,000 to maintain in Congo, it is hard to see where the fresh troops are going to come from. If this force is to become a reality, therefore, there will have to be a step-change in African attitudes towards peacekeeping duties, backed by more money from the West. The Sudanese will also have to accept troops from Asia and other parts of the world, whether they like it or not.

Vigilance will be needed as the Sudanese government picks away at the detail of the resolution to hinder an effective deployment as much as it can. That has been its tactic with both the existing AU force in Darfur and the 10,000-strong UN force in south Sudan. Since the arrival of UN troops in Darfur represents a defeat for the government, it will try to wriggle out of its obligations in any way it can. The outside world needs both to prevent that and to ensure that any build-up in Darfur does not diminish the separate mission in the south, where an uneasy peace agreement is still holding. Keeping calm in the

south, which emerged from decades of war with Khartoum only in 2005, is just as important a humanitarian imperative as pacifying Darfur.

Then there is the business of brokering a peace deal in Darfur itself. Since the last attempt failed last year, the rebel groups have splintered into ever more rancorous and undisciplined factions, making the job even harder. In Tanzania on August 3rd-5th diplomats are due to try again. Here too, pressure must be brought on the rebel groups to form more coherent negotiating blocks if any agreement with the Sudanese government is to stick. Only then will the wretched survivors of what has become the world's worst humanitarian disaster be able to contemplate an end to their nightmare.

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Upper-house elections in Japan

The humiliation of Shinzo Abe

Aug 2nd 2007
From The Economist print edition

But without an opposition that is fit to govern, Japan may be stuck with its flawed ruling party

AP

Japan's politics

JAPAN has now had what by any standards were two extraordinary elections, back-to-back and less than two years apart. They were extraordinary not least because they had opposite outcomes. In 2005 the then prime minister, Junichiro Koizumi, called a snap general election, arguing over the head of his own party the case for reform—in particular, the privatisation of the huge postal-savings system, fount of so much political patronage. The result was a landslide victory for his Liberal Democratic Party (LDP) and its junior partner, New Komeito. Yet on July 29th, in elections for half the seats in the upper house of the Diet (parliament), the LDP suffered at the hands of the Democratic Party of Japan (DPJ) its biggest electoral defeat since its founding in 1955. For the very first time it has lost its dominance in the upper house. Despite this humiliation for his party and himself, Shinzo Abe, prime minister since September 2006, amazingly insists that he still has a mandate to stumble on. A spell of political turmoil in Japan seems all but guaranteed.

What changed in two years? That question requires three answers: one to do with the personality of Mr Abe, one with the legacy of Mr Koizumi and the last with Japan's continuing aversion to painful but necessary reforms.

Mr Abe, by a million miles, is no Koizumi. Everyone knew that Mr Koizumi was a consummate showman and a hard act to follow: a possibly unique Japanese politician with a flair for the common touch. But Mr Abe, Japan's first prime minister to be born after the second world war, was picked by his party as a worthy because youthful successor. Since then, alas, he has shown himself to be diffident, patrician and out of touch with people's everyday concerns. On top of this came a seemingly unending series of scandals, gaffes and resignations that have tarnished his cabinet—the latest resignation came on August 1st. Voters appear to have flayed the ruling coalition in the upper house as punishment for Mr Abe's priorities, incompetence and character (see article).

The second answer is that just as Mr Koizumi was responsible for the landslide victory in 2005, so he had much to do with the LDP's 2007 defeat. Though by reputation an economic reformer, the biggest change he wrought was on his own party. He declared war on the factions and other networks of patronage through which money and power flowed, and which kept politicians, bureaucrats and businessmen in the same cosy bed. When party apparatchiks chafed, he threw them out or encouraged celebrities to run against them. (Mr Abe did nothing for his popularity by bringing some of the outcasts back.) Mr Koizumi helped smash the vote-getting machine on which the LDP could once depend, especially in the countryside. The LDP's savage defeat in rural areas on July 29th is proof of his success. Mr Koizumi once said that he wouldn't mind destroying his party in order to further his reforms. Judging from these

election results, he seems to have done a pretty good job.

A third explanation for the voters' vehemence may bode less well for Japan: that all along they were dazzled more by Mr Koizumi's performance than by his message of painful change before gain. At least in part, Sunday's vote was a vote against reform. With growth spreading through the urban parts of Japan, the sense of economic crisis on which Mr Koizumi played is past. Yet wages are stagnant, while the more depopulated parts of Japan are feeling little of the recovery. Indeed, Koizumi-era changes are starting to hurt: in particular, cuts in public-works spending and increases in local taxes as prefectures shoulder more of the fiscal burden. This was fertile ground for the DPJ's leader, Ichiro Ozawa, who ran his campaign as the farmer's friend and champion of the regions—just like the old, unreconstructed LDP.

Smash the old idols

Some political scientists see the election as a necessary step towards a long-cherished dream—a system of two parties competing on policy and alternating in power. Dream on. Mr Abe's refusal to quit may underline the disarray his party is in, but it distracts attention from the corresponding mess in the DPJ. It may succeed in bringing Mr Abe down, perhaps later this year or early next, and an early general election may be called. Yet the closer it comes to real power, the more unprepared the DPJ, a ragbag of conflicting groups, will prove. Mr Ozawa, whose health is not strong, does not relish being prime minister, and his backroom style frustrates modernising colleagues. The DPJ shows no sign of being a party ready to hold power.

So an unpredictable period looms for Japanese politics, with the ship of state under the LDP likely to prove rudderless, accident-prone and even corrupt—and nothing better to be expected from the opposition. So what's new? One bright thing: Japanese voters, once so respectful of authority, now appear quick to vote the bums out. Not for the first time, one-party rule in Japan seems doomed. Sadly, it is liable to limp on until an opposition that looks fit to govern emerges.

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America, India and the China bogey

A price too high

Aug 2nd 2007
From The Economist print edition

The rise of China is no reason to trample on the non-proliferation regime

Reuters

SLOWLY but seemingly relentlessly, America's deal with India on nuclear co-operation is wending its way to fruition. Two years after it was first announced in Washington by George Bush and Manmohan Singh, India's prime minister, the two countries have concluded negotiations on the terms of a technical agreement governing that co-operation. Both sides have claimed a great breakthrough. Nicholas Burns, the State Department official who has shepherded the deal through a maze of complications, called it "perhaps the single most important initiative in the 60 years of our relationship". M.K. Narayanan, Mr Singh's national-security adviser, called it "a touchstone of a transformed bilateral relationship". That once distant ties between America and India are warming up is indeed cause for celebration. But the heat also burns a huge hole in the global non-proliferation regime. As this newspaper has argued ever since the deal was first mooted, this is wrong, dangerous and unnecessary.

India first tested a nuclear device in 1974 (and became a declared nuclear-weapons state in 1998), inspiring the Nuclear Non-Proliferation Treaty, which it, like Pakistan and Israel, never signed, and which its agreement with America perhaps fatally undermines. Yet in both Delhi and Washington, DC, opposition to the agreement tends to be dismissed as nitpicking that ignores a fundamental shift. India, which tilted Soviet-wards during the cold war, and remains by far the most powerful exponent of "non-alignment", is entering a "strategic partnership" with America. The world's oldest democracy is at last going to be on the closest of terms with its largest democracy. What could make more sense, when, in the background, a potentially hostile, undemocratic Asian giant is rapidly gaining economic weight, and adding military muscle? To spare everybody's blushes, the rise of China is rarely mentioned as a factor in America's nuclear exception for India. But it is perhaps the fundamental impulse behind it.

Yet linking an end to India's nuclear isolation to the need for a strategic hedge against the rise of China makes no sense. No threat from China is either so great or so pressing. Its army is indeed modernising and spending lavishly. But as our briefing points out (see article), its military budget, in hard-currency terms, is not much bigger than France's. It remains decades away from being able to mount a credible military challenge to American pre-eminence. Moreover, whereas conflict remains possible, especially over Taiwan, China's priorities are internal: coping with the social and political dislocation that its economic revolution entails.

Nor is the nuclear prize going to buy undivided Indian loyalty. Mr Singh's leftist parliamentary allies will balk at anything that smacks of toeing America's line, and especially of jettisoning close ties with Iran, an American priority. Nehruvian "non-alignment" runs deep. Even Mr Singh—liberal economist and leader of

the drive for better relations with America—felt compelled last year to call Fidel Castro “one of the greatest men of our times”. The main opposition Bharatiya Janata Party (BJP), in government when India went nuclear in 1998, is stridently nationalist. Yashwant Sinha, the BJP's most recent foreign minister, has criticised the government already for giving America too much.

Conversely, the collapse of the deal is not going to fling India into any sort of embrace with China. Relations, still scarred by their war in 1962, are improving apace. China will soon be India's largest trading partner. But mutual suspicion and rivalry for resources mean that China will remain India's main strategic threat—the one it cited to justify the 1998 nuclear tests. No matter what nuclear stance America takes, India can be relied on to keep a healthy distance from China.

How to send all the wrong messages

China, then, is no justification for the damage America's nuclear concessions to India will do. They may yet trip at the remaining hurdles: in the American Congress; at the International Atomic Energy Agency; or the 45-member Nuclear Suppliers Group. The text of the latest agreement has not been made public. But from what has been said about it, it makes the damage far worse, by allowing India to reprocess American-supplied nuclear fuel, and by permitting it to build fuel stockpiles and hence withstand any future cut-off of supplies should it test another bomb. America claims that other aspirant nuclear powers, notably Iran, will learn the benefits of good behaviour—ie, of India's fairly respectable record on non-proliferation. More likely, however, the rewards India (and North Korea) are reaping will encourage countries without the bomb to strive to acquire one as soon as possible.

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Nigeria

Mission impossible, nearly

Aug 2nd 2007
From The Economist print edition

After fraudulent elections a new and tainted president faces a mountain of problems

AP

THERE must be few other countries on earth with such a glaring mismatch between their actual state and their extraordinary potential. Some call Nigeria Africa's slumbering giant. It more often behaves like the continent's suicidal maniac.

With 140m people, Africa's most populous country is the world's eighth-largest oil exporter. That has earned Nigeria about $223 billion in revenues over the past eight years alone. Yet so wasted has this windfall been that most Nigerians continue to live in squalor and poverty. The country ranks 159th out of 177 on the UN's human-development index. For all the energy resources that lie under Nigerians' feet, the fitful power supply dips at times to levels last seen when the country became independent nearly half a century ago.

The cause of all this is extravagant corruption and mismanagement, coupled with a political culture that owes more to the principles of gangsterism than to any textbook on democracy. April's elections were marked by violence and fraud on a scale that boggled the imagination even of jaded Nigerian voters. Many therefore regard their new president, Umaru Yar'Adua, who after months of dithering finally formed his cabinet last week, as tainted from the start.

And yet Mr Yar'Adua may yet achieve something in his four-year term. Although he was the principal beneficiary of all the ballot-rigging, his personal reputation, acquired as a state governor, is one of probity and competence. He has certainly been saying all the right things since the election about the evils of corruption and the need for transparency. And he has a receptive audience: voters sick of the looting of their country will back a leader who seems genuine about reform.

To make the most of these slim advantages, however, Mr Yar'Adua needs to act quickly. He could start by ensuring that the next election is less farcical than the last. This requires legislation to take the commission that organises elections, and the decision on who sits on it, out of the hands of the presidency and make it truly independent of the executive. The dismally partisan performance of the commission in April's election showed that it is now “independent” in name only.

Another aim must be to strengthen the anti-corruption drive that was begun by Mr Yar'Adua's predecessor as president, Olusegun Obasanjo. The Economic and Financial Crimes Commission, which came to be used as a tool to discredit the government's opponents, must be allowed to go after anyone. It could start by prosecuting some of the former state governors, several of whom it has indicted.

Clean up the Delta, while you're about it

Cracking down on corruption could in turn help resolve the insurgency in the oil-producing Niger Delta region, which has shut down about 20% of the country's oil production. The Delta's problems do not stem from the federal government's miserliness towards local people, as is often claimed, but from the theft of the funds it sends the region. The budget of the main Delta state last year was a hefty $1.3 billion, all of this from the central government. Yet thanks to the avarice of local politicians, most was siphoned off before reaching the people, who remain some of Africa's poorest and sickest.

Mr Yar'Adua should get tough with the Delta governors to ensure that the money goes to its intended recipients. For example, he could channel more federal money into decentralised trusts and so bypass the state governors and their lackeys altogether. The Delta is where all Nigeria's plagues of political gangsterism, corruption and poverty converge. If Mr Yar'Adua can crack the Delta's woes, he may learn how to unpick some of the problems of the country as a whole.

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On Turkey, accountancy, Hong Kong, narrowcasting, Sark, the Tour de France

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No entry for Turkey

SIR – Your leader on Turkey's election faithfully echoes Washington's long-standing demand that the country be allowed to join the European Union ("Of mullahs and majors", July 21st). Europe's political class is supine. Imagine the outcry from inside the Beltway if the EU were to press Mexico's case for the unimpeded access of its nationals to the United States. Those that champion Turkey's entry into Europe do so in order to encourage the spread of secularism within the Islamic world. But is it wise to use membership of the EU as a geopolitical deus ex machina? On this basis Europe will eventually extend into Central Asia, North Africa and further into the Middle East.

A bedrock principle of the EU, which differentiates it from a free-trade area, is the free movement of peoples. Not being able to control who can reside in one's country is a depletion of fundamental sovereignty. This is tolerable only as long as the EU does not extend much beyond Western Europe. A referendum on the proposed European treaty would allow the citizens of the EU to vote No, not so much to the treaty but to the concept of an EU that borders Syria, Iraq and Iran.

Yugo Kovach
London

SIR – I agree that, so far, Recep Tayyip Erdogan, Turkey's prime minister, has hardly put a foot wrong in his endeavour to reconcile a moderate version of Islamic politics with upholding the pillars of the country's secular constitution ("The burden of victory", July 28th). It is completely wrong to assume, as some do, that he is just making nice, temporarily using democracy to pursue secretly the foundation of an Islamic state like the one in neighbouring Iran. I wish the country and its citizens every success on their arduous voyage to Europe.

Werner Radtke
Paderborn, Germany

SIR – As you suggest, a Turkish invasion of northern Iraq would be disastrous for the region. America, however, is a hypocrite on the issue. It has pledged to go anywhere in the world to fight al-Qaeda and is rightfully outraged when other countries impede its efforts to do so. It is therefore understandable that many Turks are angered by American opposition to Turkish action against the Kurdish PKK in northern Iraq, especially when the Bush administration offers no alternatives. The Turkish people deserve a basic level of respect regarding their concerns about a group who regularly kill soldiers and civilians. A failure to give them at least that will only further damage American interests.

John Oppermann
New York

An unbalanced sheet

SIR – I read your article on the difficulties experienced by women in the accounting profession with interest ("Breaks and ladders", July 21st). Research from the Institute of Chartered Accountants corroborates the need for more enlightened thinking if the profession is to increase the number of women reaching senior management positions. Although the efforts of the Big Four are to be applauded, too many highly skilled accountants fall off the career ladder because of the inflexibility of employers. The ICA found that there remains a pay differential between male and female chartered accountants, child-

care support is lacking, and women continue to be under-represented in the most senior roles. Employers are becoming increasingly aware of the problem, but more needs to be done if the profession is to attract and retain this talent pool, especially with the number of newly qualified female accountants rising rapidly.

Michael Izza
Chief executive
Institute of Chartered Accountants in England and Wales
London

Help Hong Kong's helpers

SIR – Hong Kong is indeed “flourishing”, but you failed to mention the contribution towards this success of a disenfranchised minority: Hong Kong's 230,000 domestic helpers (Special report on Hong Kong, June 30th). These are mostly Filipina and Indonesian women who care for the homes, children and elderly of Hong Kong, allowing professionals to work and thus enabling the generation of some of the economic growth you cite.

This economic contribution is not recognised, however, either in terms of pay or working conditions, and abuse of helpers is common. They are denied the right to obtain residency after seven years (as can other—mainly white—migrant workers), and the conditions under which they can change employers are very restrictive. The most difficult obstacle is the “two-week rule”, a provision that requires a helper to leave the territory within two weeks after the termination of her contract. Employers often dismiss migrants without justification and helpers need to provide proof of unfair treatment if they hope to win their case. Few have the financial resources to stay. Despite appeals for it to do so, the Hong Kong government refuses to recognise the discriminatory nature of the two-week rule.

Kingsley Smith
Hong Kong

Out on a limb

SIR – In praising the broad spectrum of media that is currently available, Lexington makes one key omission—the phenomenon of “narrowcasting” (July 21st). The information age has given voice to many diverse opinions, but consumers seem to choose news sources with ideological views similar to their own. Lexington is correct that Rush Limbaugh's niche market ensures that none of his rants will ever move the masses to take up arms, yet there is something pernicious about broadcasting to an audience that is so socially isolated.

As with the “fairness” of airwaves, the government may be ill suited to address this issue. But perhaps our leadership could inspire the more receptive and inquisitive public attitudes needed to fight this polarisation.

Nicholas Geiser
San Francisco

Channel Island story

SIR – The problems in Sark to which you allude have arisen under the island's old feudal system and are not the consequence of democratic reforms (“Democratic revolution”, July 14th). Democratic reform will bring to Chief Pleas, the parliament, the skills and experience of a large group of under-represented islanders who are currently put off by an inert legislature dominated by self interest. As a community, Sark is dependent upon everyone playing his or her part, thus the chance to play a greater role in Chief Pleas can only benefit the island. I cannot see quite how this is going to cause Sark to “throw itself upon” the protection of next door Guernsey.

Peter Cunneen
Sark

Economic stimulus

SIR – Your cover on the sustainability of Europe's economic recovery depicted cyclists panting uphill (July

14th). It was amusing and disturbing. Although some of Europe's economies may be in need of a boost, let us hope that, in the light of recent events in France, they do not imitate art. Or sport.

Tze Shiung Ng
Kuala Lumpur

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China's military might

The long march to be a superpower

Aug 2nd 2007 | BEIJING AND TIANJIN
From The Economist print edition

The People's Liberation Army is investing heavily to give China the military muscle to match its economic power. But can it begin to rival America?

THE sight is as odd as its surroundings are bleak. Where a flat expanse of mud flats, salt pans and fish farms reaches the Bohai Gulf, a vast ship looms through the polluted haze. It is an aircraft-carrier, the *Kiev*, once the proud possession of the Soviet Union. Now it is a tourist attraction. Chinese visitors sit on the flight deck under Pepsi umbrellas, reflecting perhaps on a great power that was and another, theirs, that is fast in the making.

Inside the *Kiev*, the hangar bay is divided into two. On one side, bored-looking visitors watch an assortment of dance routines featuring performers in ethnic-minority costumes. On the other side is a full-size model of China's new J-10, a plane unveiled with great fanfare in January as the most advanced fighter built by the Chinese themselves (except for the Ukrainian or Russian turbofan engines—but officials prefer not to advertise this). A version of this, some military analysts believe, could one day be deployed on a Chinese ship.

The Pentagon is watching China's aircraft-carrier ambitions with bemused interest. Since the 1980s, China has bought four of them (three from the former Soviet Union and an Australian one whose construction began in Britain during the second world war). Like the *Kiev*, the *Minsk* (berthed near Hong Kong) has been turned into a tourist attraction having first been studied closely by Chinese naval engineers. Australia's carrier, the *Melbourne*, has been scrapped. The biggest and most modern one, the *Varyag*, is in the northern port city of Dalian, where it is being refurbished. Its destiny is uncertain. The Pentagon says it might be put into service, used for training carrier crews, or become yet another floating theme-park.

American global supremacy is not about to be challenged by China's tinkering with aircraft-carriers. Even if China were to commission one—which analysts think unlikely before at least 2015—it would be useless in the most probable area of potential conflict between China and America, the Taiwan Strait. China could far more easily launch its jets from shore. But it would be widely seen as a potent symbol of China's rise as a military power. Some Chinese officers want to fly the flag ever farther afield as a demonstration of China's rise. As China emerges as a trading giant (one increasingly dependent on imported oil), a few of its military analysts talk about the need to protect distant sea lanes in the Malacca Strait and beyond.

This week China's People's Liberation Army (PLA), as the armed forces are known, is celebrating the 80th year since it was born as a group of ragtag rebels against China's then rulers. Today it is vying to become one of the world's most capable forces: one that could, if necessary, keep even the Americans at bay. The PLA has little urge to confront America head-on, but plenty to deter it from protecting Taiwan.

The pace of China's military upgrading is causing concern in the Pentagon. Eric McVadon, a retired rear admiral, told a congressional commission in 2005 that China had achieved a “remarkable leap” in the modernisation of forces needed to overwhelm Taiwan and deter or confront any American intervention. And the pace of this, he said, was “urgently continuing”. By Pentagon standards, Admiral McVadon is doveish.

In its annual report to Congress on China's military strength, published in May, the Pentagon said China's “expanding military capabilities” were a “major factor” in altering military balances in East Asia. It said China's ability to project power over long distances remained limited. But it repeated its observation, made in 2006, that among “major and emerging powers” China had the “greatest potential to compete militarily” with America.

Since the mid-1990s China has become increasingly worried that Taiwan might cut its notional ties with the mainland. To instil fear into any Taiwanese leader so inclined, it has been deploying short-range ballistic missiles (SRBMs) on the coast facing the island as fast as it can produce them—about 100 a year. The Pentagon says there are now about 900 of these DF-11s (CSS-7) and DF-15s (CSS-6). They are getting more accurate. Salvoes of them might devastate Taiwan's military infrastructure so quickly that any war would be over before America could respond.

Much has changed since 1995 and 1996, when China's weakness in the face of American power was put on stunning display. In a fit of anger over America's decision in 1995 to allow Lee Teng-hui, then Taiwan's president, to make a high-profile trip to his alma mater, Cornell University, China fired ten unarmed DF-15s into waters off Taiwan. The Americans, confident that China would quickly back off, sent two aircraft-carrier battle groups to the region as a warning. The tactic worked. Today America would have to think twice. Douglas Paal, America's unofficial ambassador to Taiwan from 2002 to 2006, says the “cost of conflict has certainly gone up.”

The Chinese are now trying to make sure that American aircraft-carriers cannot get anywhere near. Admiral McVadon worries about their development of DF-21 (CSS-5) medium-range ballistic missiles. With their far higher re-entry velocities than the SRBMs, they would be much harder for Taiwan's missile defences to cope with. They could even be launched far beyond Taiwan into the Pacific to hit aircraft-carriers. This would be a big technical challenge. But Admiral McVadon says America “might have to worry” about such a possibility within a couple of years.

Once the missiles have done their job, China's armed forces could (so they hope) follow up with a panoply of advanced Russian weaponry—mostly amassed in the past decade. Last year the Pentagon said China had imported around $11 billion of weapons between 2000 and 2005, mainly from Russia.

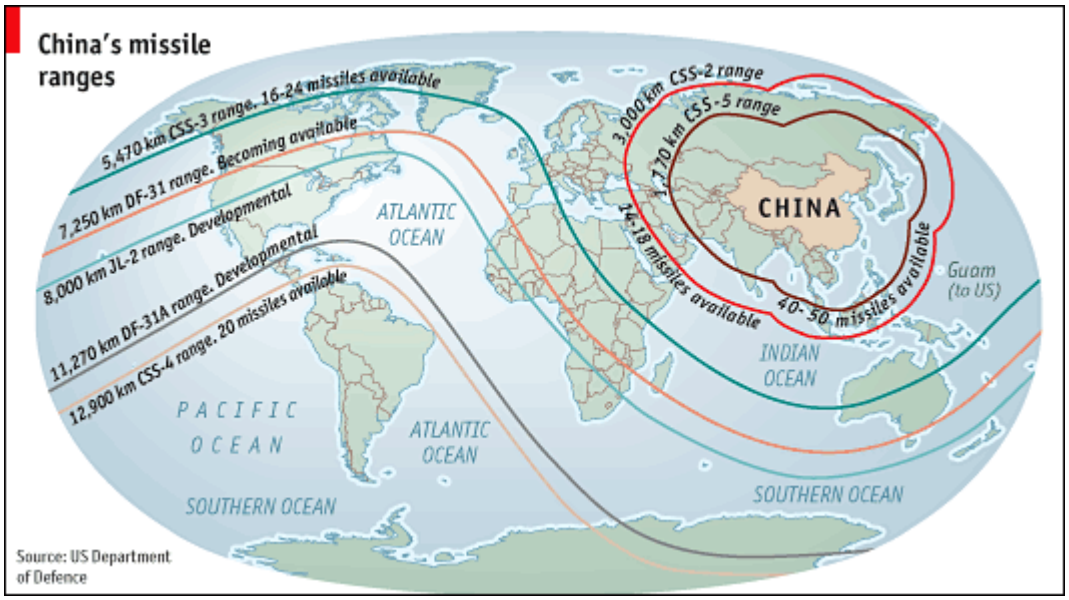
China knows it has a lot of catching up to do. Many Americans may be unenthusiastic about America's military excursions in recent years, particularly about the war in Iraq. But Chinese military authors, in numerous books and articles, see much to be inspired by.

On paper at least, China's gains have been impressive. Even into the 1990s China had little more than a conscript army of ill-educated peasants using equipment based largely on obsolete Soviet designs of the 1950s and outdated cold-war (or even guerrilla-war) doctrine. Now the emphasis has shifted from ground troops to the navy and air force, which would spearhead any attack on Taiwan. China has bought 12 Russian Kilo-class diesel attack submarines. The newest of these are equipped with supersonic Sizzler cruise missiles that America's carriers, many analysts believe, would find hard to stop.

There are supersonic cruise missiles too aboard China's four new Sovremenny-class destroyers, made to order by the Russians and designed to attack aircraft-carriers and their escorts. And China's own shipbuilders have not been idle. In an exhibition marking the 80th anniversary, Beijing's Military Museum displays what Chinese official websites say is a model of a new nuclear-powered attack submarine, the Shang. These submarines would allow the navy to push deep into the Pacific, well beyond Taiwan, and, China hopes, help defeat American carriers long before they get close. Last year, much to America's embarrassment, a newly developed Chinese diesel submarine for shorter-range missions surfaced close to the American carrier *Kitty Hawk* near Okinawa without being detected beforehand.

American air superiority in the region is now challenged by more than 200 advanced Russian Su-27and Su-30 fighters China has acquired since the 1990s. Some of these have been made under licence in China itself. The Pentagon thinks China is also interested in buying Su-33s, which would be useful for deployment on an aircraft-carrier, if China decides to build one.

During the Taiwan Strait crisis of 1995-96, America could be reasonably sure that, even if war did break out (few seriously thought it would), it could cope with any threat from China's nuclear arsenal. China's handful of strategic missiles capable of hitting mainland America were based in silos, whose positions the Americans most probably knew. Launch preparations would take so long that the Americans would have plenty of time to knock them out. China has been working hard to remedy this. It is deploying six road-mobile, solid-fuelled (which means quick to launch) intercontinental DF-31s and is believed to be developing DF-31As with a longer range that could hit anywhere in America (see map below), as well as submarine-launched (so more concealable) JL-2s that could threaten much of America too.



All dressed up and ready to fight?

But how much use is all this hardware? Not a great deal is known about the PLA's fighting capability. It is by far the most secretive of the world's big armies. One of the few titbits it has been truly open about in the build-up to the celebrations is the introduction of new uniforms to mark the occasion: more body-hugging and, to howls of criticism from some users of popular Chinese internet sites, more American-looking.

As Chinese military analysts are well aware, America's military strength is not just about technology. It also involves training, co-ordination between different branches of the military ("jointness", in the jargon), gathering and processing intelligence, experience and morale. China is struggling to catch up in these areas too. But it has had next to no combat experience since a brief and undistinguished foray into Vietnam in 1979 and a huge deployment to crush pro-democracy unrest ten years later.

China is even coyer about its war-fighting capabilities than it is about its weaponry. It has not rehearsed deep-sea drills against aircraft-carriers. It does not want to create alarm in the region, nor to rile America. There is also a problem of making all this Russian equipment work. Some analysts say the Chinese have not been entirely pleased with their Su-27 and Su-30 fighters. Keeping them maintained and supplied with spare parts (from Russia) has not been easy. A Western diplomat says China is also struggling to keep its Russian destroyers and submarines in good working order. "We have to be cautious about saying 'wow'," he suggests of the new equipment.

China is making some progress in its efforts to wean itself off dependence on the Russians. After decades of effort, some analysts believe, China is finally beginning to use its own turbofan engines, an essential technology for advanced fighters. But self-sufficiency is still a long way off. The Russians are sometimes still reluctant to hand over their most sophisticated technologies. "The only trustworthy thing [the Chinese] have is missiles," says Andrew Yang of the Chinese Council of Advanced Policy Studies in Taiwan.

The Pentagon, for all its fretting, is trying to keep channels open to the Chinese. Military exchanges have been slowly reviving since their nadir of April 2001, when a Chinese fighter jet hit an American spy plane close to China. Last year, for the first time, the two sides conducted joint exercises—search-and-rescue missions off the coasts of America and China. But these were simple manoeuvres and the Americans

learned little from them. The Chinese remain reluctant to engage in anything more complex, perhaps for fear of revealing their weaknesses.

The Russians have gained deeper insights. Two years ago the PLA staged large-scale exercises with them, the first with a foreign army. Although not advertised as such, these were partly aimed at scaring the Taiwanese. The two countries practised blockades, capturing airfields and amphibious landings. The Russians showed off some of the weaponry they hope to sell to the big-spending Chinese.

Another large joint exercise is due to be held on August 9th-17th in the Urals (a few troops from other members of the Shanghai Co-operation Organisation, a six-nation group including Central Asian states, will also take part). But David Shambaugh of George Washington University says the Russians have not been very impressed by China's skills. After the joint exercise of 2005, Russians muttered about the PLA's lack of “jointness”, its poor communications and the slowness of its tanks.

China has won much praise in the West for its increasing involvement in United Nations peacekeeping operations. But this engagement has revealed little of China's combat capability. Almost all of the 1,600 Chinese peacekeepers deployed (including in Lebanon, Congo and Liberia) are engineers, transport troops or medical staff.

A series of “white papers” published by the Chinese government since 1998 on its military developments have shed little light either, particularly on how much the PLA is spending and on what. By China's opaque calculations, the PLA enjoyed an average annual budget increase of more than 15% between 1990 and 2005 (nearly 10% in real terms). This year the budget was increased by nearly 18%. But this appears not to include arms imports, spending on strategic missile forces and research and development. The International Institute for Strategic Studies in London says the real level of spending in 2004 could have been about 1.7 times higher than the officially declared budget of 220 billion yuan ($26.5 billion at then exchange rates).

This estimate would make China's spending roughly the same as that of France in 2004. But the different purchasing power of the dollar in the two countries—as well as China's double-digit spending increases since then—push the Chinese total far higher. China is struggling hard to make its army more professional—keeping servicemen for longer and attracting better-educated recruits. This is tough at a time when the civilian economy is booming and wages are climbing. The PLA is having to spend much

more on pay and conditions for its 2.3m people.

Keeping the army happy is a preoccupation of China's leaders, mindful of how the PLA saved the party from probable destruction during the unrest of 1989. In the 1990s they encouraged military units to run businesses to make more money for themselves. At the end of the decade, seeing that this was fuelling corruption, they ordered the PLA to hand over its business to civilian control. Bigger budgets are now helping the PLA to make up for some of those lost earnings.

The party still sees the army as a bulwark against the kind of upheaval that has toppled communist regimes elsewhere. Chinese leaders lash out at suggestions (believed to be supported by some officers) that the PLA should be put under the state's control instead of the party's. The PLA is riddled with party spies who monitor officers' loyalty. But the party also gives the army considerable leeway to manage its own affairs. It worries about military corruption but seldom moves against it, at least openly (in a rare exception to this, a deputy chief of the navy was dismissed last year for taking bribes and “loose morals”). The PLA's culture of secrecy allowed the unmonitored spread of SARS, an often fatal respiratory ailment, in the army's medical system in 2003.

Carrier trade

The PLA knows its weaknesses. It has few illusions that China can compete head-on with the Americans militarily. The Soviet Union's determination to do so is widely seen in China as the cause of its collapse. Instead China emphasises weaponry and doctrine that could be used to defeat a far more powerful enemy using “asymmetric capabilities”.

The idea is to exploit America's perceived weak points such as its dependence on satellites and information networks. China's successful (if messy and diplomatically damaging) destruction in January of one of its own ageing satellites with a rocket was clearly intended as a demonstration of such power. Some analysts believe Chinese people with state backing have been trying to hack into Pentagon computers. Richard Lawless, a Pentagon official, recently said China had developed a “very sophisticated” ability to attack American computer and internet systems.

The Pentagon's fear is that military leaders enamoured of new technology may underestimate the diplomatic consequences of trying it out. Some Chinese see a problem here too. The anti-satellite test has revived academic discussion in China of the need for setting up an American-style national security council that would help military planners co-ordinate more effectively with foreign-policy makers.

But the Americans find it difficult to tell China bluntly to stop doing what others are doing too (including India, which has aircraft-carriers and Russian fighter planes). In May Admiral Timothy Keating, the chief of America's Pacific Command, said China's interest in aircraft-carriers was “understandable”. He even said that if China chose to develop them, America would “help them to the degree that they seek and the degree that we're capable.” But, he noted, “it ain't as easy as it looks.”

A senior Pentagon official later suggested Admiral Keating had been misunderstood. Building a carrier for the Chinese armed forces would be going a bit far. But the two sides are now talking about setting up a military hotline. The Americans want to stay cautiously friendly as the dragon grows stronger.

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Political corruption

Investigating Alaska

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From The Economist print edition

Altrendo RR

State and federal officials are facing a pile of indictments and inquiries. The common thread: oil

ALASKA is famous for big bears, big salmon, big mountains; and, increasingly, big legal trouble for its politicians. The state's lone congressman, Don Young, a Republican, is being scrutinised by the FBI for links to an Alaskan company whose two top executives bribed state legislators. Lisa Murkowski, the state's Republican junior senator, made headlines in mid-July when it was suggested that she had purchased property on the Kenai river without disclosing the transaction, as she was legally bound to, in her annual financial statement.

Now comes disturbing news about Ted Stevens, a senator for Alaska for the past 39 years. On July 30th agents from the FBI and the Internal Revenue Service scoured a home owned by “Uncle Ted” in Girdwood, a suburb of Anchorage. The agents removed materials linked to allegations that Mr Stevens's home was remodelled in 2000 as a gift from VECO, a company that builds and manages pipelines and other oil infrastructure. It was two VECO executives—Bill Allen, the chief executive, and Rick Smith, a vice-president—who pleaded guilty in May to bribery.

Neither Mr Stevens nor Mr Young has been indicted. Ms Murkowski, who insists she has done nothing wrong, seems to have side-stepped further damage by agreeing to sell back the property in question. But the current investigations are the latest in a string of corruption and bribery charges in Alaska. The tipping point came with the VECO guilty pleas. Since then, three state lawmakers—Vic Kohring, a current representative, and two former representatives, Pete Kott and Bruce Weyhrauch, all Republicans—have been charged with accepting $400,000 from VECO in exchange for helping the firm win contracts for a proposed natural-gas pipeline and blocking legislation unfavourable to oil interests.

In late July the *Wall Street Journal* detailed contributions of at least $157,000 from VECO employees to Mr Young, most of it raised at summer “pig roasts” in Anchorage. Investigators are trying to determine if any money was unreported, or could be construed as a bribe. Mr Stevens, meanwhile, is under a cloud for the remodelling project that doubled the size of his house. Mr Allen oversaw the project. At least one contractor who worked on the house told the *Anchorage Daily News* that he was instructed to send bills to VECO, where they were “examined” before going to Mr Stevens.

For both Mr Stevens and Mr Young, the bad press and public humiliation are in stark contrast to the enormous power they have wielded over the years. Mr Stevens, who is 83 and the longest-serving Republican in the Senate, has used his influence to steer millions of dollars to Alaska. Visitors flying into Anchorage land at Ted Stevens International Airport. Mr Young has been the state's representative since

1973, after a special election that followed the death of the sitting Democrat in a plane crash. He too has directed vast sums to his home state. But his star dimmed considerably in 2005, when he attempted to put $223m of federal money into a transport bill to build what became known as the “bridge to nowhere”.

Oil is at the bottom of the trouble. Since the mid-1970s Alaska has been awash in money from oil pumped from Prudhoe Bay. Companies such as VECO could make huge sums by supplying equipment and services to big oil companies. Contacts with state politicians always helped. More recently, the indicted state representatives are believed to have helped VECO and oil companies to fight efforts to raise state taxes on oil—taxes that are now among the lowest in the world. “Most producing countries tax oil at 70% to 90% of the net profits,” says Ray Metcalfe, a former state legislator who has been an outspoken critic of the intersection of oil and state politics. “Here, we tax it at 7%.”

Add to that the clubby nature of a state with only 670,000 residents. “Favours for pals is just a way of life up here,” says John Strohmeyer, a journalist who has lived in Alaska since 1987 and has written books about its oil and fishing industries. One of the great oddities of the state is that neither Mr Stevens nor Ms Murkowski was elected to their current office at first. Both were appointed—in Ms Murkowski's case by her father, Frank Murkowski, when he was governor.

Both Mr Young and Mr Stevens are up for re-election in 2008. Democrats are lining up to run against Mr Young. None has appeared yet to challenge Mr Stevens, but that will change. And one thing is certain. Alaska's governor, Sarah Palin, who crushed Mr Murkowski in the 2006 primary by pledging a break with the past, will call a special legislative session this autumn. Its sole purpose: to raise oil taxes.

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Race relations

Where black and brown collide

Aug 2nd 2007 | DURHAM AND LOS ANGELES
From The Economist print edition

The struggle for political dominance pits natural allies against each other

TWO men will soon stand trial in Los Angeles in a murder case that does not involve white cops, a sportsman or a music producer. As a result, the trial is unlikely to receive minute-by-minute coverage on cable TV. Yet it will reveal as much about the edgy state of race relations in Los Angeles as the cases of Rodney King or O.J. Simpson. Perhaps more so, since it involves the two groups between which there is most tension. The accused men, Ernesto Alcarez and Jonathan Fajardo, are Hispanic. The victim, 14-year-old Cheryl Green—who, prosecutors say, died in a racially motivated attack—was black.

In the rarefied world of national politics (and in America's even more other-worldly universities) blacks and Latinos tend to be lumped together in what Nicolás Vaca, a California lawyer, calls a "presumed alliance". Last month Barack Obama, a Democratic presidential candidate whose father was Kenyan, assured a Hispanic conference that such a bond existed. Quoting Martin Luther King, he called the two groups "brothers in the fight for equality". On the streets of America's cities, however, rather less lofty attitudes are apparent.

"We're being overrun," says Ted Hayes of Choose Black America, which has led anti-immigration marches in south-central Los Angeles. "The *compañeros* have taken all the housing. If you don't speak Spanish they turn you down for jobs. Our children are jumped upon in the schools. They are trying to drive us out." Not, Mr Hayes emphasises, that he has anything against illegal immigrants personally, or against Mexicans who are in America legally. Indeed, he says, in that useful old phrase, he is friendly with many of them.

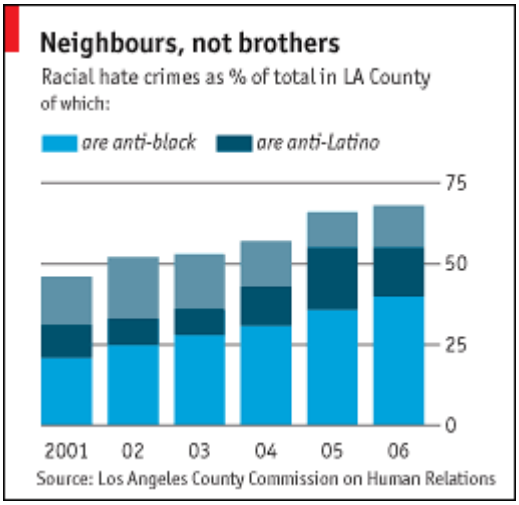
Last year Pew, a pollster, found that one-third of blacks believe immigrants take jobs from Americans—more than any other group. Yet in some ways their views were benign. Blacks are less likely than whites or even Hispanics to believe that immigrants end up on welfare or commit crimes. Latinos, on the other hand, appear to make no such concessions. One survey of Durham, in North Carolina, found that 59% of Latinos believed few or almost no blacks were hard-working, and a similar proportion reckoned few or almost none could be trusted. Fewer than one in ten whites felt the same way.

Fifteen years ago such prejudices hardly existed in Durham, for the simple reason that there were hardly any Latinos. Like much of the South, the city was biracial, with roughly equal numbers of blacks and whites. Then came a building boom that drew workers from Mexico, many of them illegal. By 2000 one in 12 residents of Durham was Latino—up from one in 80 a decade earlier. By 2005, one in eight was. Mauricio Castro, a local activist, says the change has hit the city like a storm.

That storm has broken most heavily on the poorest parts of Durham, which happen to be black. It is in largely black neighbourhoods that wooden shacks have been converted into call centres and *carnicerias* (and it is, inevitably, often blacks who have robbed new arrivals of their weekly wages). In this, Durham is typical. By 2000 blacks in all ten of America's biggest metropolitan areas were more mixed in with Hispanics than with whites. In Los Angeles, former ghettos such as Watts are now biracial.

In poor areas, closeness often means conflict. Los Angeles tallied more than 400 racial hate crimes last year—the most, as a proportion of all hate crimes, for at least a decade (see chart). Blacks fared worst: they comprise just 9% of the population of Los Angeles County but were the victims of 59% of all race-hate crimes. Seven times out of ten, their persecutors were Latino. Hispanics, who make up almost half the population, were victimised by blacks eight-tenths of the time. These numbers greatly understate the violence. They do not, for example, include the victims of a dozen interracial prison riots last year, which left two dead.

Gangs tend to be held responsible for such outrages, which is only partly fair. The 204th Street gang, which is alleged to be behind the murder of Cheryl Green, has a reputation for attacking innocent blacks. And gang members who have done time in California's racially divided jails often develop especially sharp attitudes. Yet gangs often express broadly held views, though in a violent way. Besides, says Robin Toma, the head of the county's human relations commission, gangs can affect the views of law-abiding folk. When bullets start flying, a turf war can easily turn into a broader racial conflict.



The powerless majority

One reason blacks and Latinos have failed to form an alliance is philosophical. The black civil-rights struggle, in the South at least, was mostly about asserting legal rights and demolishing barriers to voting by those who were, in theory, already enfranchised. The Latino struggle is quite different. Its goal is often the selective or non-enforcement of the law, particularly on immigration. A common demand, for example, is for local police not to co-operate with federal immigration agents. And, whereas blacks in the 1960s demanded power in proportion to their numbers as adult citizens, Hispanics want rather more.

Thanks partly to their youth and partly to the fact that many are not citizens, Latinos are not nearly as powerful as their numbers might suggest. In Durham, where they are more than 13% of the population, the Latino vote is negligible. Even in historically Hispanic California they comprise more than a third of the population but cast only about a fifth of the votes. The imbalance between numbers and power irks many Latinos. And since they increasingly live in areas where political power is held by blacks, it often sharpens racial resentments.

In Compton, an independent city in south Los Angeles, Latinos are now 58% of the population—and rising quickly. Yet the mayor and all the members of the council are black. “They got here first, took over from the whites, and now it's difficult for them to let go,” says Alex Leon, a local pastor. Sensing the future tsunami of Latino political power, Compton's mayor has begun to cultivate Hispanics. It may be too late. In the next-door city of Lynwood, Hispanics were largely kept out of power until they became a majority. After seizing control of the city council in 1997 they demolished the black political machine.

Such ethnic squabbles, which are almost inevitable in the zero-sum game of urban politics, can shape attitudes. And they may help to explain one of the most striking features of the 2008 presidential race: the lack of Latino support for Mr Obama. In June a Gallup poll showed that black Democrats were evenly divided between Mr Obama and Hillary Clinton, while whites gave Mrs Clinton a 16-point lead. Among Hispanics, however, the senator from New York led by a crushing 46 points—despite Mr Obama's impeccably liberal line on immigration.

So far, rivalry between blacks and Hispanics has been a mostly working-class affair. But Earl Ofari Hutchinson, who is writing a book on black-Latino relations, reckons that is likely to change. Latinos are already so entrenched in some manual trades that it is hard to see how they can become more dominant. In construction, for example, they account for a quarter of the national workforce and outnumber blacks almost five to one. The next citadels to be stormed will be white-collar, largely female preserves such as public administration, education and health.

In Los Angeles the struggle for such jobs is well under way. Every month the Los Angeles County Chicano Employees Association produces a newsletter illustrating the shortage of Latinos in the top ranks of yet another government office. These reports nearly always show that blacks are over-represented. In the department of children and family services, for example, some 36% of managers are black, 29% are white and just 20% are Hispanic. Yet the reports also show that, over time, Hispanics have steadily taken high-level jobs from both blacks and whites.

If blacks and Hispanics are not brothers in the fight for equality, nor are they locked in a titanic struggle like the one between blacks and whites in the mid-20th-century South. Thankfully, there is far less violence. And the fact that leaders on both sides talk of a common cause probably helps. Yet one thing is

the same: the group on top wants to stay there. Indeed, power hard-won from whites may be even more difficult to give up. As parts of Durham begin to resemble south-central Los Angeles, tensions between blacks and Latinos can only increase.

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City gangs

Living with cockroaches

Aug 2nd 2007 | LOS ANGELES
From The Economist print edition

In future in Los Angeles, only the worst will be stomped on

AP

Now run along, there's a good boy

EARLIER this year Ray Peavy, then head of Los Angeles County's homicide squad, was asked what should be done about gangs. “The same thing you do about cockroaches or insects,” he replied. It's a good comparison, although not in the way Mr Peavy intended. The history of Los Angeles is full of bold declarations of war, none of which has dislodged the city from its undisputed status as the gang capital of America. As anybody who has suffered the critters knows, it is almost impossible to get rid of cockroaches.

For the past few months, though, the city's cops have followed a different, more promising, strategy. First, they named 11 gangs that they would target. This tactic has been resisted in the past, since to name a gang is to glorify it and to admit that previous efforts to eradicate it have failed. The cops even produced a map showing gang territories. As a result, potential homebuyers can now look up not just the local school results but also whether they are moving into the turf of Mara Salvatrucha or the Rollin' 60's Neighbourhood Crips.

The second difference is that, Mr Peavy aside, the cops have not promised to stamp out any gangs, even the targeted ones. “They can exist,” says William Bratton, the head of the Los Angeles Police Department (LAPD), “but they must behave.” A gang that murders people will be harried by civil injunctions and crackdowns on petty probation violations. A gang that avoids extravagant violence—as many do—will be left alone, more or less.

So far the strategy appears to be working. Between the start of January and the end of June, the LAPD counted 102 gang murders; by the same point last year there had been 143. Most encouragingly, crime has declined in most of the precincts where the targeted gangs are based. The only area that saw more gang crime was the San Fernando Valley, where only one gang has been harried.

Whether this benign trend continues is another matter. The police have done a terrific job of hounding the vicious 204th Street gang, says Najee Ali, a former member of the Crips. But eventually the officers will move on to deal with other miscreants. When (and it is when, not if) the gang recovers, will it have learned the lesson that the police are trying to teach it?

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Alberto Gonzales

A visit to the hospital

Aug 2nd 2007
From The Economist print edition

Only George Bush can save the attorney-general now

EPA

Hopelessness personified

IN MARCH 2004 the White House asked the Department of Justice to certify the legality of a certain classified programme. John Ashcroft, then attorney-general, decided that it was not legal. Several hours after reaching this decision, Mr Ashcroft was stricken with pancreatitis and rushed to hospital, where he remained for more than a week. James Comey, his deputy, became acting attorney-general. He told the White House that the Justice Department would not authorise the programme.

Several days later Mr Comey received a message from Janet Ashcroft. Alberto Gonzales and Andrew Card were en route to the hospital to see her husband. Mr Gonzales was then legal counsel to the White House, and Mr Card was Mr Bush's chief of staff. Mr Comey found this alarming.

He raced to the hospital and ran up the stairs to Mr Ashcroft's darkened room. Mr Ashcroft was sedated and disoriented. So Mr Comey called Robert Mueller, the director of the FBI, who "instructed the FBI agents present not to allow me to be removed from the room under any circumstances." Mr Gonzales and Mr Card arrived soon after and explained to Mr Ashcroft that they wanted his approval to re-authorise the programme.

"And Attorney-General Ashcroft then stunned me," continued Mr Comey. Mr Ashcroft lifted his weary head from the pillow and explained why the programme was illegal. In any case, he continued, there was no point in coming to see him in the hospital, as Mr Comey was the acting attorney-general. Then Mr Ashcroft laid back, seemingly spent.

Mr Comey declined to specify the matter that was so important, but the Senate Judiciary Committee assumed that it was the terrorist surveillance programme, which authorised the National Security Administration to eavesdrop on international calls without a warrant. Last week Mr Mueller, who was at the hospital but not in the room, testified to the House Judiciary Committee that this was indeed the programme under discussion.

Mr Mueller's testimony directly contradicts that of his former boss, Mr Gonzales, who succeeded Mr Ashcroft as attorney-general. Mr Gonzales has repeatedly testified, under oath, that there was no serious disagreement within the Justice Department about the wiretapping programme. Just last week he told the Senate Judiciary Committee that he went to the hospital to discuss "other intelligence activities".

Legally speaking, Mr Gonzales may not have lied. Several days after his testimony Mike McConnell, the director of national intelligence, released a letter explaining that the wiretapping programme was just one of a number of secret surveillance activities, most of which have not been disclosed. Perhaps the argument in the hospital room was over data mining rather than eavesdropping. And perhaps Mr Gonzales is merely a weasel and not a perjurer.

Either way, everyone is fed up. Mr Gonzales's tenure as attorney-general has been strewn with scandals and unmitigated by triumph. This latest bit of dissembling may be his last in the office. Senate Democrats want him investigated for perjury and a handful of counterparts in the House are calling for his impeachment. According to a July 30th SurveyUSA poll, only a quarter of Americans who are following the story (and almost half say they are) have confidence in Mr Gonzales.

Even Republicans have turned against him. “Fox News Sunday” looked for a White House official to defend Mr Gonzales last weekend, but could find no volunteers. True, Dick Cheney, the vice-president, says he is “a big fan”. But Mr Gonzales's few defenders have been reduced to saying that perhaps he is merely incompetent.

In any other administration Mr Gonzales would have been sacked long ago. But George Bush values loyalty above all. He and Mr Gonzales have been friends since Mr Bush was governor of Texas and Mr Gonzales was general counsel and Texas's secretary of state. Mr Bush must still value Mr Gonzales's willingness to act as a White House goon. Or perhaps he is a sort of human shield, taking knocks that might otherwise be directed at people above his pay grade.

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Student lending

Fair sailing for young scholars

Aug 2nd 2007
From The Economist print edition

A radical sort-out for the beer-and-book money

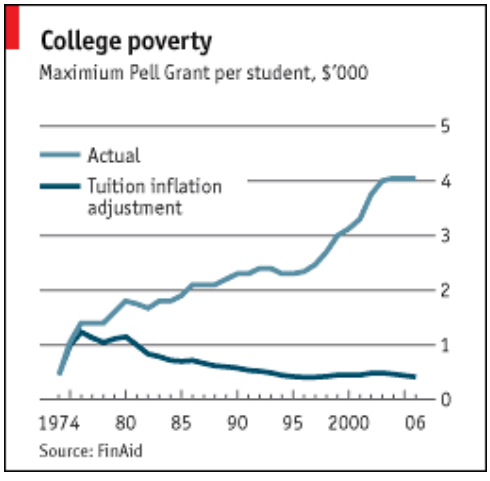
THE 110th Congress has been neither bipartisan nor effective, but one act is sailing through nimbly. Both the House and the Senate have recently passed bills to reform student lending, and observers think a final bill may land on the president's desk in a month.

Democrats have always been critical of federal interest-rate subsidies to private lenders, which is how student loans are organised. Now that they control Congress, and have a Republican president on their side, they are taking action to improve matters. They are spurred on by scandal—many lenders like Student Loan Xpress have been caught handing illegal kickbacks to college aid officials—and by the fact that a private-equity consortium, led by J.C. Flowers, is in the process of buying out Sallie Mae, the largest student lender. This has put a spotlight on the fat margins of the $85 billion-a-year student-loan industry, where Sallie Mae's five-year average return on equity was an astonishing 52% per year.

At present the federal government subsidises student loans in two ways. First, the government lends through the William D. Ford direct loan programme, which competes with private lenders and has about a quarter of the student-loan market. Second, private lenders get subsidies that allow them to lower the interest rates they charge students. In the past, lenders have successfully resisted proposed reductions to their subsidies of as little as ten basis points by threatening to leave the market. Now the bills are proposing to reduce subsidies by 50-55 basis points.

The principal terms of both bills are sensible. They increase the maximum “Pell Grant” for low-income students from $4,050 currently to $5,400 by 2011. The funding comes by cutting about $18 billion-19 billion in lender subsidies over five years. Next, graduates' loan repayments are capped at a manageable percentage of income and all debt is cancelled after 25 years of repayment. Finally, the bills provide more loan forgiveness for graduates who enter public-service careers, including police, firefighters, nurses and inner-city teachers. Taken together, these are the biggest changes since the student-loan system was created, in 1965, as part of Lyndon Johnson's Great Society programmes.

The biggest risk in cutting the interest-rate subsidies is that banks may leave student lending *en masse*, or that smaller lenders may be forced out of the market. This would mean less choice for students and possibly a large number of borrowers swamping the government programme. “Congress still wants lending to be profitable, just not too profitable,” says Ajita Talwalker of TICAS, a non-partisan institute that studies the accessibility and affordability of higher education. This may prove a tough balancing act, since no one knows what the right number is.



Critics still find the bills defective. Higher-education costs have risen much faster than inflation or aid increases, so students have been paying more out-of-pocket and taking more private loans. Yet both bills do little to tackle the rise in tuition costs. Richard Vedder of Ohio University points out that productivity is a major problem; professors in many schools have a weekly teaching workload that is a third lighter than 40 years ago, but their pay and benefits have increased.

All sides agree there needs to be more transparency in costs and an element of price competition. As far as the bills at hand are concerned, many experts are calling for the House to drop its entitlement programmes, which make certain spending mandatory, and to direct the money to the Pell Grants.

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Illegal immigration

A Haven indeed

Aug 2nd 2007 | NEW HAVEN
From The Economist print edition

One city devises its own immigration policy

Get article background

MARICELA was eight when, with her parents, she crossed the border from Mexico. Twelve years later, a high-school graduate with an American accent, she is still illegal, unable easily to rent a flat, open a bank account or get a library card. She and the 10,000-12,000 other undocumented immigrants in New Haven, Connecticut, are hoping that a new policy may make their lives better.

As the federal government has proved itself incapable of formulating an immigration policy, local governments are stepping in as they did on health care and the environment. New Haven, home to Yale University, is already considered a sanctuary for illegal immigrants. It offers help in filing federal taxes, and it has ordered its police not to inquire about immigrants' status. Last week it became the first city to issue its own ID card. All 125,000 residents may have one: legal and illegal, children as well as adults.

The card cannot be used for federal or state services, but it will allow holders to use city beaches and libraries. It can also be used as a debit card at many downtown restaurants and shops, and for parking meters. Two banks, First City and Sovereign, have agreed to accept the card, allowing users to open accounts. Until now, most of the city's undocumented immigrants were forced either to carry their cash or to hide it at home, making themselves easy targets for muggers and burglars.

These immigrants, mostly from Latin America, make up most of the block-long application queue at city hall. The card costs $10 for adults and $5 for children. The rest of the programme's costs will be funded by a $250,000 grant from First City.

In June the town's board of aldermen approved the measure by a vote of 25 to one. Less than two days later, immigration and customs enforcement agents conducted home raids on undocumented immigrants, with 32 arrests. Only five of those arrested had outstanding warrants. John DeStefano, New Haven's mayor, suspects the raids were in retaliation for the card. Michael Chertoff, the secretary of homeland security, has denied it. Further raids have been suspended.

City officials say the data collected during the application process will be kept confidential. Information will probably not be shared with the federal government unless someone is under criminal investigation. Michael Wishnie, a Yale law professor who has been retained by the city to fight any court challenges, points out the cards are no different from records already possessed by the Internal Revenue Service and by health and welfare agencies.

While cities like New York, Miami and San Francisco are considering adapting similar programmes, others are trying to tighten laws. Last year Hazelton, a small Pennsylvania town, began fining landlords who rent to illegal immigrants and penalising employers for hiring them. On July 26th a federal judge struck down the measure. The ruling has national implications, as 100 other cities have adopted something similar.

New Haven's anti-immigration groups say the cards violate federal laws against aiding illegal immigration. And they fear the city will be inundated with illegal migrants. But it is not easy to obtain a card. Residents must show valid government-issued photo identification, such as a passport, driving licence or consular document. They must also prove residency in New Haven with two utility bills, a pay stub, tax statements, or documents from health and social-service agencies. About 25-50% of applicants are turned away for not having the papers required. Maricela did not get a card; she could not prove she was a resident of New Haven.

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Troubled Republicans

Of seals and Newts

Aug 2nd 2007 | WASHINGTON, DC
From The Economist print edition

Sharp advice for candidates from a familiar face

ALL the Republican presidential candidates are struggling, and everyone thinks they know why. Voters are angry with George Bush and his party or weary of scandals involving congressional Republicans. Rudy Giuliani has married too many women and Mitt Romney is a Mormon.

But no one has a better explanation than Newt Gingrich. The candidates, he says, are “pathetic”. In fact, one might compare them to pygmies. They debase themselves and the office they seek by trotting around the country to field questions from television celebrities. You would never catch him, Newt, “standing like a trained seal, waiting for someone to throw me a fish.” He is a magnificent man, like Charles de Gaulle.

These observations have caused commotion in the past few weeks. Mr Gingrich, a former speaker of the House who bedevilled Democrats throughout the 1990s, always has cutting remarks on offer and few attract much attention. But the summer is dragging on, and no Republican is a sure bet for his party's nomination. A majority of primary voters are dissatisfied with their options. And Mr Gingrich's criticisms are salient. Just this week, Mr Romney announced that he would skip a scheduled debate sponsored by CNN and YouTube, partly because he considers it beneath his dignity to field any old question the YouTube crowd is inclined to ask.

The current thinking around Washington is that Mr Gingrich will endorse Fred Thompson, the former senator and television actor whose unannounced candidacy is polling better than Mr Romney's and is in better shape financially than John McCain's. The key piece of evidence for this theory is that Mr Gingrich and his wife recently had dinner with the Thompsons.

But there is an off-chance that Mr Gingrich will attempt a run himself. He has acknowledged the possibility, saying he will wait until October to see if any of the pygmies manage to win the hearts of Republican primary voters. A Newt in the offing would certainly enliven the race.

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Lexington

Gotcha!

Aug 2nd 2007
From The Economist print edition

David Simonds

America is coming to terms with Rupert Murdoch's purchase of one of its great journalistic institutions

RUPERT MURDOCH'S takeover of the *Wall Street Journal* is a spectacular business coup (see article). Mr Murdoch has pocketed one of the country's two best-respected newspapers. He has paid top dollar for the *Journal*'s parent company, Dow Jones. And he has arguably provided the *Journal* with the mixture of capital and management grit that it needs to thrive.

And the reaction in the land of capitalism red in tooth and claw? Decidedly sniffy. It is as if Mr Murdoch has barged into a posh club wearing a Lycra tracksuit and an “I love Australia” T-shirt and offered to buy everyone a pint of Foster's.

Mr Murdoch is no stranger to controversy in his adopted country. The media establishment regards him as a brash outsider. The left hates Fox News (the Democratic presidential candidates even refused to appear at a Fox-sponsored debate). But the criticism has always been limited by his focus on tabloid news and entertainment. Nobody expects the *New York Post* or Twentieth Century Fox to be run as public trusts. Mr Murdoch built Fox News from the ground up. He spotted a market niche—the 50% of the population who think that TV news leans too far to the left—and filled it with gusto.

The *Wall Street Journal* is different. It is the very embodiment of the highest journalistic standards. Ever since Mr Murdoch began to stalk the *Journal*, the news media has been singing with stories of his barbarities. How he habitually breaks his promises that he will protect journalistic independence. How he uses his media empire to advance his business interests or pursue personal feuds. How he fills his British tabloids with topless girls and bombastic headlines. How he kowtows to the Chinese government. This is the first time that American criticism of the man (whom *Private Eye*, a British satirical magazine, has dubbed “the Dirty Digger”) has reached British levels.

The left has been vocally against. The *Huffington Post* website marked the news of the deal by reproducing several front-page stories from Mr Murdoch's tabloids. On August 1st protesters from Moveon.org gathered outside Dow Jones's headquarters to hand out parody headlines to demonstrate “the type of unreliable, partisan information businesspeople can expect from the news pages of the *Journal* under Rupert Murdoch.”

The sight of left-wing activists rallying to defend the *Journal* is amusing. But Mr Murdoch has also

received criticism from an unfamiliar quarter: his fellow conservatives. Conservatives have long celebrated Mr Murdoch as a kindred spirit and business buccaneer. But some of them worry that his acquisition of the *Journal*'s op-ed pages—the Bible of American conservatism—will give him too much power over the movement.

Paleocons and populists dislike his enthusiasm for immigration. Neocons dislike his penchant for doing business with China. Social conservatives disapprove of his tabloid smut. They all worry about his weakness for pragmatism. The *Washington Times* ran an op-ed piece lambasting him for holding a fund-raising breakfast for Hillary Clinton, “the scariest spectral [sic] of conservative nightmares”.

The reason for all this fuss lies in the nature of the two beasts involved—the *Journal* and the mogul. The *Journal* is as good as it gets in terms of high-quality journalism. It is also one of only three national newspapers. Mr Murdoch is a tabloid king who has a reputation for taking everything he buys downmarket. The *Journal* is the gold standard of business reporting. Mr Murdoch is one of the biggest beasts in the business jungle, constantly on the prowl for synergies and acquisitions. Isn't there a problem in one of the players owning the scorecard that everybody uses? The *Journal* is not really one newspaper but two—a newspaper and a highly opinionated conservative magazine. Hitherto it has succeeded in drawing a line between them. Will Mr Murdoch resist allowing his own conservative opinions to blur that line?

For many, Mr Murdoch is a threat to the whole American journalistic tradition. Jim Ottaway, a former vice-president of Dow Jones, argues that there is a sharp difference between the Anglo-Australian model of media ownership and the American one. Anglo-Australian bosses are in the habit of expressing their various biases through their newspapers and TV channels. The American journalistic tradition depends on a “strict separation between political opinions expressed vigorously on editorial pages and news reported with as much factual objectivity as possible.” Mr Murdoch is a barbarian at the gates indeed.

Printer's-ink dynasties

How much truth is there in all this? The best American newspapers are certainly superior to their Anglo-Australian counterparts in terms of depth and seriousness. But this may have more to do with the size and structure of the market and the American penchant for professionalism than with ownership. If Mr Murdoch degrades the *Journal*, he will be destroying the very thing for which he is paying such a premium—the paper's reputation.

The Bancroft family was certainly an ideal steward when it came to guaranteeing the *Journal*'s independence. But is the same true of all American media families? The Grahams at the *Washington Post* and the Sulzbergers at the *New York Times* have exercised considerable influence over their papers' tone, coverage and personnel. Mr Ottaway is describing the exception rather than the rule.

Mr Murdoch is much more like America's great newspaper proprietors than his critics imagine. He has printer's ink in his veins. He is investing in the newspaper business at a time when others are heading for the hills. And he runs News Corporation much like a family firm, with special voting rights that allow the family to resist the pressures of quarterly earnings. Perhaps the newest member of America's press-barons' club is not such an outsider after all.

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Correction: Sinclair Broadcast Group

Aug 2nd 2007
From The Economist print edition

In our Lexington column of July 19th we said that Sinclair Broadcast Group used its “market dominance” of the talk-radio business to push a right-wing agenda. Sinclair does not own a radio station, has not been in the radio business for almost seven years and pushes no agenda, right-wing or otherwise. We apologise.

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Haiti

A small success for the UN

Aug 2nd 2007 | PORT-AU-PRINCE
From The Economist print edition

AFP

Security is improving in what was a Caribbean failed state. Poverty and policing are harder to tackle

Get article background

A PAIR of boats are anchored just past the edge of a dock that juts out from Cité Soleil, a vast slum in Haiti's capital. Their masts are tree trunks winding crookedly towards the sky. On a late July day, the air stagnant with the smell of garbage, there is no wind to fill their sails. On the dock men sit, some idle, some mending nets, while naked boys swim around them in the dirty water. It is a scene of desperate poverty, but also of uncertain peace.

The United Nations has been charged with keeping the peace in Haiti since the ousting of Jean-Bertrand Aristide in February 2004. But, until recently, there was very little peace to be kept, particularly in the capital. Gang violence and kidnapping ravaged Port-au-Prince; Cité Soleil, in the hands of local gangs, was its focal point.

Last December, under a new Brazilian general, the UN force moved into Cité Soleil, setting up bases and shooting it out with the gangs. As the UN took charge, local residents turned against the criminals, nearly all of whose leaders have now been killed or captured. In February, UN troops would enter Cité Soleil only in armoured vehicles. Now they patrol on foot.

Some streets in Cité Soleil have been paved with stones and cement; some rubbish is being picked up. Street markets are back, though there is little to sell, and few buyers—78% of Haitians live on less than $2 a day, according to the World Bank. Ask almost any resident of Cité Soleil whether life has changed in the past six months and he will tell you, yes—before he used to be poor and shot at, and now he is just poor.

Nevertheless, a start has been made. Foreign leaders are dropping in to see it. Last month Canada's prime minister, Stephen Harper, whose government has given much aid to Haiti, visited Cité Soleil—something that would have been unthinkable only months ago.

This week the UN secretary-general, Ban Ki-moon, was in Port-au-Prince. Though there are some complaints of misconduct by troops, most Haitians want the UN to stay. Canada apart, most of the money for the mission comes from the United States and France, and most of the troops from Latin America. Mr Ban said he will recommend that the mission's mandate be extended for at least another

year when it expires in October.

The UN can declare victory only if it leaves behind an effective police force. That is still a long way off. Edmond Mulet, the mission's head, reckons that at least 22,000 police are needed, but a new force has just 8,000 members. Some 500 new recruits are being added every six months—though recent vetting saw a similar number fired.

In Cité Soleil, the police only patrol in tandem with UN forces. Police stations have not been rebuilt. Their crumbling walls carry the ubiquitous pockmarks of bullets and are surrounded by garbage. But Haiti's police are a model of efficiency compared with the courts and the overcrowded prisons. Three attempts to reform the judiciary have stalled in parliament.

This weak law-enforcement machinery faces a powerful drug-trafficking industry. Haiti is a busy transhipment point for Colombian cocaine bound for the United States. Drug money has long since infiltrated politics. Last month American helicopters from Guantánamo Bay narrowly missed capturing Guy Philippe, who led a rebel band which helped to topple Mr Aristide and whom the United States regards as a drug kingpin. Having evaded the helicopters, he went on the radio to proclaim his innocence. Under an agreement dating from 1997, the United States captures drug suspects in Haiti without formal extradition proceedings.

René Préval, who was elected as Haiti's president last year, is widely seen as competent, as are some of his senior officials. Though the country lacks a civil service, there are a few faint signs of economic revival. It helps that kidnappings are down, from a peak of 80 in August 2006 to just six in June, according to the UN. In the biggest single foreign investment of recent times Digicel, a Bermudan mobile-phone operator, has spent $260m since entering the country in May 2006. It already claims 1.4m customers, or one Haitian in six. Ghada Gebara of Digicel says she has managed to find qualified local staff, though with difficulty.

Hopes of creating more jobs turn mainly on a revival of the export clothing industry, which was substantial until Haiti's descent into chaos in the 1990s. The United States has granted sweeping tariff-free access to Haitian apparel exports, giving the country an edge over the preferences enjoyed by the neighbouring Dominican Republic and by Central America. But to take advantage of this, roads, ports and airports all need upgrading.

Debate is starting over whether to privatise not just the ports and airports but the state-owned electricity and telecoms companies as well. Most of those Haitians who have electricity obtain it from their own generators or from batteries, since blackouts are the norm. In recent months the telecoms company, which operates landlines, has halved its workforce.

In a rare press conference during Mr Harper's visit, Mr Préval likened his country to a “small sailboat” which is “likely to be damaged by a wind that is not too strong.” Like the fishing vessels at Cité Soleil, Haiti's economy and administration remain underpowered and rudimentary. But the country is starting to move again, however hesitantly.

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Colombia's peace process

Demob unhappy

Aug 2nd 2007 | BOGOTÁ
From The Economist print edition

A precarious arrangement is at risk

Get article background

TWO years ago President Álvaro Uribe promulgated a controversial law to regulate the demobilisation of some 31,000 members of the right-wing paramilitary groups who for years fought left-wing guerrillas by inflicting a reign of terror in the Colombian countryside. The law pardoned the rank-and-file fighters while offering reduced sentences to those charged with crimes against humanity—in return for their co-operation with investigators. Their assets were to be used to compensate victims. The official hope was that this offered an acceptable balance between the conflicting interests of justice, reparation and the achievement of peace with an undefeated outlaw army.

Yet two years on, nobody is satisfied. Rights groups say the law is a cloak for impunity. The paramilitary leaders complain that they were duped by promises of lenient treatment, since broken. Officials say peace has been sabotaged by the courts. Hundreds of former fighters are re-arming.

Universal dissatisfaction might suggest to some that the government has got the balance right—except that the whole precarious structure of the peace process now looks at risk of crashing down. Last month the Supreme Court ruled that the rank-and-file paramilitaries could not be considered to have committed (and thus be pardoned for) the political crime of sedition, as the law envisages.

The court's argument was that the paramilitaries did not rise against the state, but acted in complicity with some army officers and politicians to defend economic interests (such as those of drug-traffickers). So, it ruled, they engaged in a criminal conspiracy for which they cannot be pardoned or amnestied.

That may be legally true. But Mr Uribe accused the court of double standards in having considered in the past that the crimes of the left-wing guerrillas, which include the murder and kidnap of civilians as well as drug-trafficking, are political in nature. The jailed paramilitary leaders responded to the ruling by threatening to end collaboration with the authorities. They desisted only after the government sent Congress a new bill to grant them political status. But even if the bill is passed, it may well be knocked down by the courts.

Mr Uribe's critics say that this impasse reflects the improvised way in which the peace process has been conducted. Officials counter that the process was bound to be messy, and that its flaws can be corrected as it goes along. They point out that no other country has put so many people on trial while conflict continues.

Only 44 paramilitaries (out of a potential 3,000) have begun giving their courtroom confessions. Some 70,000 people have applied to be officially registered as victims. The attorney-general's office seems overwhelmed, and impatience among the victims is mounting.

When militia leaders began their confessions in December, throngs of victims packed into anterooms where they could watch the hearings through a live video feed. But as one leader after another recounted massacres and disappearances with no remorse, and blamed many crimes on long-dead leaders, disillusion has grown. “The truth that we were promised from all this is not coming forth,” says Iván Cepeda, who leads a national victims' organisation. Scores of victims have received death threats, and at least three have been murdered this year.

Whereas the government pays a stipend to the former fighters, the victims have yet to receive anything. Even so, the biggest fear is that more of the demobilised paramilitaries will return to arms and crime. The Supreme Court's decision could encourage that, says Gustavo Duncan, the author of a book on the paramilitaries. But he reckons that the jailed leaders have no choice but to stick with the process, not

least because for some it is the only safeguard against extradition to the United States on drugs charges. For all its problems, the likelihood is that the peace process will stumble on.

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Cuba

Conceptual change

Aug 2nd 2007 | HAVANA
From The Economist print edition

Raúl Castro sets out his stall while Fidel hovers in the background

Get article background

A YEAR ago this week, Fidel Castro announced that he required intestinal surgery and that he had temporarily turned over his powers as Cuba's head of state and government to his slightly younger brother, Raúl. One year on, by all accounts, Fidel Castro continues to recover from complications that almost killed him. But it is slowly dawning on Cubans that change and the post-Fidel era have begun.

To most outward appearances, everything in the communist island remains the same. Most of the observable differences are cosmetic. There are fewer government-organised mass rallies. Television schedules are no longer re-arranged around Fidel's lengthy musings and eccentric schedule. Raúl likes to keep normal office hours.

The clearest sign so far that deeper change is afoot came on July 26th, the official anniversary of the start of the revolution. Fidel would use the occasion to expatiate on the statistics of Cuban economic triumphs, or to excoriate the enemy across the water in the United States. By contrast, Raúl Castro's hour-long speech to a crowd of 100,000 in Camaguey contained some unusually sharp criticism of Cuba's own shortcomings.

The standard wage of around $15 a month was “clearly insufficient to satisfy all needs,” he said, stating the previously unutterable obvious. This was the main cause of “social indiscipline” (ie, the black market, which Fidel has tended to blame on personal greed). “Structural and conceptual changes will have to be introduced” to raise productivity, Raúl went on. By way of example, he singled out as “absurd” the centralised system for producing milk. He also called for more foreign investment, and invited America's next president to “talk in a civilised manner” to Cuba.

“Raúl is raising new expectations,” says Oscar Espinosa Chepe, a dissident economist. Can he satisfy them? As long as Fidel lives, reformers within the leadership will have to be cautious. Hardliners will put up less resistance against economic reform than against any loosening of one-party control. Still, there is no longer much talk of the elder Mr Castro returning to power.

Apart from seeing the occasional visitor, Fidel's only public activity is publishing articles in the official newspaper, *Granma.* After four articles about the doings of Cuba's athletes at the Pan-American Games, his column this week returned to politics. It gave warning that “no one should entertain the slightest illusion” that the United States will negotiate with Cuba and noted that he is consulted on “every important decision”. Maybe, but it now looks as if Raúl, not Fidel, is the man who makes them.

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Brazil

Fight in the favelas

Aug 2nd 2007 | RIO DE JANEIRO
From The Economist print edition

Rio cracks down on crime. But the police are at least half the problem

Reuters

Sending the pigs in

THE bomb squad has packed up. Most of the 25,000-strong force of federal troops and state police, replete with riot gear and sniffer dogs, has returned to normal duties. For the last two weeks of July the Pan American games turned Rio de Janeiro into one of the world's most closely guarded places. Elsewhere, the suffocating security might make locals nervous. But Cariocas, as Rio's residents are known, rejoiced as the usual hectic pace of murder, assault and car theft slowed. They worry about what might happen now that the athletes have gone home.

Every governor of Rio for the past 20 years has vowed to stamp out violent crime, only to see the body count rise. With 40 murders per 100,000 residents, greater Rio de Janeiro is nearly three times as dangerous as São Paulo. Between 2000 and 2006 the city of Rio averaged one murder every 3½ hours, according to police statistics. One study, by the Organisation of Ibero-American States for Science and Culture, found that young men aged between 15 and 24 die each year at a rate of 101 per 100,000 in the city—a startling figure for a country not at war.

Sérgio Cabral, who took over as the governor of Rio state on January 1st, seems rather more determined than his predecessors to match promises with action. In the run-up to the games, he ordered the state police, backed by a federal task-force, to invade the Complexo do Alemão, a sprawling slum on the city's outskirts said to be the centre of drug trafficking.

The incursion was bloody. To date, 44 people have been killed there, 19 of them in a single battle in June. Human-rights advocates say that the police shot several victims in the back, typically a sign of execution. And yet many Cariocas approved. Singled out at a concert hall on a recent evening, the state secretary of public safety, José Beltrame, who masterminded the police raid, was given a hero's ovation.

Time and again the police have “liberated” the slums that cling to the hillsides only for the criminals to return when the heat is off. Residents of the Complexo do Alemão say the traffickers are already back in business after dark, plying their wares and wielding their guns in the Grota, the slum's main thoroughfare.

This time will be different, officials claim. Hours after the games closed, the city police raided half-a-dozen *favelas* (shantytowns). Brazil's president, Luiz Inácio Lula da Silva, announced that 75% of the police cars, helicopters and surveillance gear deployed last month will remain in Rio. He has also promised federal money to improve the poorest neighbourhoods. Cariocas, Mr Cabral says, will have to “get used to the stress of war”.

So may other parts of Brazil. Nationally, murders increased by more than 5% a year between 1980 and 2004, according to a recent study by the Institute of Applied Economic Research, a government think-tank. The institute concluded that criminal violence costs Brazil more than 5% of GDP, taking into account both the cost of private security measures and lost income.

Even so, Rio stands out. Years of official lassitude, inefficiency and outright corruption have slowly poisoned the city's law-enforcement. Many scholars trace the malady back a century when police began to take a cut from the wildly popular illegal lottery called the *jogo de bicho*. The *bicheiros*, as the numbers mafia was called, came out of the shadows once a year to sponsor Rio's carnival, laundering

their profits and reputations. In time, the *bicheiros* were replaced by deadlier drug traffickers, who inherited the police's tolerance.

Brazil's forgiving labour code, which makes it difficult to fire public servants, has not helped. State officials have repeatedly purged police ranks only to see the corrupt reinstated by court order. Equally unhelpful has been the Cariocas' soft spot for populist leaders who have handed over plum law-enforcement posts to cronies. Meanwhile, the state police are the second-worst-paid in the country.

So it is not surprising that the police's performance is so poor. The number of arrests in the state fell by 37% between 2002 and 2006. Forensics are shoddy: examining evidence can take up to three months. Only 3% of murder suspects are ever brought to trial, says Luiz Eduardo Soares, a former state official.

As well as being incompetent, the Rio police are among the most brutal in the world. Last year more than 1,000 people in the state died at their hands, a 250% rise over 2002. “More than intervention by police, Rio needs intervention into its police force,” says José Vicente da Silva, a retired police colonel. Whether or not Mr Cabral has the stomach for that is not clear. But for a few days last month, Cariocas had a rare glimpse of what a safe city might be like.

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Corrections: Panama and Brazil

Aug 2nd 2007
From The Economist print edition

In our story on Panama ("Glitter and Graft", July 19th) we said that COSCO, China's government-owned shipping operator, was competing to build a mega-port on the Caribbean coast. In fact it is on Panama's Pacific coast. In last week's story on Brazil ("Extinct, or just adapting?") we said that Ciro Gomes's wife is a senator. She is not; his former wife is. These errors have been corrected online.

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Japan

Keeping his head just above water

Aug 2nd 2007 | TOKYO
From The Economist print edition

Claudio Munoz

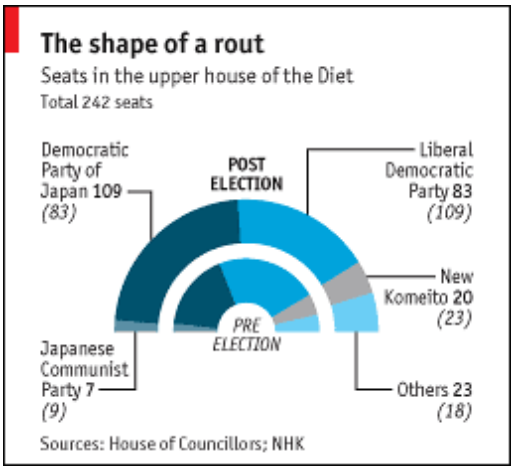
Humiliation for the LDP, but Shinzo Abe pretends it's a mandate

Japan's politics

FOR a land with more than its share of seismic activity, the outcome on July 29th of elections for half the seats in the upper house of the Diet (parliament) was a Big One. It was, by some measures, the worst electoral drubbing for the Liberal Democratic Party (LDP) since its long and almost unbroken reign began in 1955.

In cities and in the rural districts that were once the LDP's unassailable stronghold, party grandees tumbled, including the party's number two in the upper house. Of the 29 rural single-seat districts that were contested, the party's bag fell from 23 to six; overall the LDP suffered a net loss of 27 seats (see chart). The opposition Democratic Party of Japan (DPJ) doubled its share of seats. As a result the LDP for the first time in its history is no longer the biggest party in the upper house. Even with its junior coalition partner, New Komeito, it falls embarrassingly short of a majority.

Shinzo Abe, the prime minister, sits in the lower house, where the ruling coalition still commands a big majority. But the vote was a damning judgment on him personally. His popularity began on a high last autumn, thanks to fairly youthful looks and a swift attempt to improve troubled ties with China and South Korea. His ratings have since then slid with scarcely a pause and still have found no floor.



The vote was a rejection of Mr Abe's priorities, which emphasise ideological issues of nationhood, such as instilling patriotic education, rewriting the pacifist constitution and expanding the role of the Japanese armed forces. Many Japanese are not opposed to such measures, but they rate them far below pocketbook concerns: a shortage of decent jobs for the young; stagnant wages; rising health-care costs; uncertain pensions; and swathes of the depopulated countryside missing out on the economic recovery that has taken hold in Tokyo and other big cities. Mr Abe's blunder, contend Richard Katz and Peter Ennis from the *Oriental Economist*, a newsletter, was to think that the recovery would take care of these concerns by itself.

The vote was also a rejection of Mr Abe's competence—a rather too easy target, perhaps. Instead of filling

his cabinet either with eager young reformers or with more practised masters in the LDP's dark arts of getting things done, his generally ineffectual appointments have been responsible for a string of scandals and verbal blunders. One farm minister killed himself before the scale of his corruption became public. His successor, Norihiko Akagi, became the latest in a series of ministerial departures when he resigned on August 1st under suspicion of fiddling political expenses. Mr Akagi had appeared on the campaign trail with his face mysteriously covered in plasters. It became a metaphor for Mr Abe's entire administration.

Above all, voters rejected Mr Abe's character—stiff (his fun-loving wife promises he is different in private) and out of touch. Admittedly, he had to follow Junichiro Koizumi, who charmed the country for five years, delivering a landslide lower-house victory for the LDP in 2005, before dancing off the stage a year ago. And this is why this summer's scandal over the 50m missing pension records dealt Mr Abe such a blow. Mr Koizumi the iconoclast would have boosted his standing by attacking both the bureaucrats and the politicians who protected them. Mr Abe, by contrast, first hushed up the pension agency's ineptitude and then seemed not to understand why it mattered.

The pensions fiasco was Mr Abe's Hurricane Katrina, says Gerald Curtis of New York's Columbia University. The missing records were not his fault and will no doubt be cleared up. But the episode said a lot about the man.

Shan't go

In the past, prime ministers have resigned for lesser defeats. Mr Abe, bewilderingly, refuses to go. Indeed, he claimed this week that voters understood that his policies were not wrong. It is merely “the people's wish to have us reflect on the things we should reflect on and to refresh our minds.” So that's all right then.

That Mr Abe can even think of carrying on gives an idea of the confusion in his party. Even his political godfather, Yoshiro Mori, a former prime minister, seemed at the weekend to give up on Mr Abe. But if he will not jump, nobody can bring himself to push him—at least, not yet. It is not clear who would want his job just now.

In the coming weeks Mr Abe will be preoccupied with a cabinet reshuffle, even bringing in heavyweights from enemy factions if they can be persuaded. Koichi Kato, who himself made a tilt in 2000 against an ineffective leadership, says that party unity will prevail for as long as everybody thinks they have a shot at high office, but that disappointment will set in as soon as a reshuffle is announced. Meanwhile, a replacement will have to be found for Hidenao Nakagawa, who resigned this week as the LDP's secretary-general. Colleagues say the best candidate is Taro Aso, the foreign minister. But he fancies his chances of succeeding Mr Abe, and could not easily launch his bid from that position.

So Mr Abe stumbles on for now, and colleagues even talk of co-operation with the DPJ. That sounds fanciful. Akira Nagatsuma, a DPJ politician who achieved fame this year for uncovering the pensions fiasco, says that his party's aim is to do all it can to bring down the government and force an early general election (technically none is due until 2009). Even cleaning up the mess at the pensions agency, says Mr Nagatsuma, will have to wait.

The first real test comes in the autumn with the renewal of emergency measures that allow Japanese oil tankers in the Indian Ocean to resupply the NATO-led coalition in Afghanistan. The DPJ's leader, Ichiro Ozawa, vows to block the measures in the upper house—he believes that any projection of Japanese military power must be authorised by the United Nations. Japan's withdrawal would signal the end to its commitment to the “war on terror”, and strain its security relationship with the United States. The administration of George Bush is mildly alarmed. This week the American ambassador, Thomas Schieffer, sheepishly admitted that the opposition leader of America's most important Asian ally refuses to meet him.

The government still has the ability to overturn any veto in the upper house with its two-thirds majority in the lower one. But it thinks it cannot do this too often without angering a public with notions about fair play. All the while, the DPJ can make things worse by sitting on legislation in the upper house. Such frustrations make it more likely that Mr Abe will be forced to go, perhaps by the end of this year or more probably in the first half of 2008. Once a new LDP leader was found, a general election would then be called. If at any time before then New Komeito gambled on leaving the coalition, the government would fall immediately.

That is when the DPJ's real challenge will begin. The party is riven by more factional bickering than is the LDP. And Mr Ozawa has little desire to be prime minister. Even as the election results were coming in, he was nowhere to be seen—ill health was said to be the reason, but arrogance may have come into it.

A period of political uncertainty looms, then, and possibly new leaders for Japan's two biggest parties. How much it matters is another question. The prospects for farm liberalisation in the near run have gone from slight to nil. New bilateral free-trade negotiations will be pulled from the table. A debate about a hike in the consumption tax as a way to tackle the budget deficit will also be postponed, as, perhaps, will be an expected interest-rate rise by the Bank of Japan. On the other hand, growth is likely to chug along at about 2% a year or so, providing jobs and record profits at companies, as well as paying higher revenues into the exchequer. Politicians may be amazed to find that things can carry along without them.

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ASEAN

Past it at 40?

Aug 2nd 2007 | BANGKOK
From The Economist print edition

South-East Asia's regional block disappoints again

IT WAS a “victory for human rights”, crowed the Philippines' foreign minister, Alberto Romulo. Meeting in Manila on July 30th, he and his counterparts from the Association of South-East Asian Nations (ASEAN) said they had overcome the objections of Myanmar, the block's worst rights-abuser, and agreed to create a regional human-rights watchdog. They were praised by Burmese pro-democracy groups and by New Zealand's foreign minister, Winston Peters, who was also in Manila this week: he called it “a sign of maturity that's fast emerging in ASEAN.”

But whenever ASEAN congratulates itself on something, it is always worth checking the fine print. The summit's final communiqué made no commitment to setting up such a rights body. All the ministers did was persuade Myanmar not to veto discussion of the proposal at a summit of ASEAN's heads of government in November. At that summit they will celebrate ASEAN's 40th birthday—although this in fact falls on August 8th—and sign a new charter, intended to give new substance and impetus to the block.

The charter will supposedly take ASEAN a great stride towards becoming a European Union-style integrated economic and political grouping. Earlier this year a group of “eminent persons”, charged with making recommendations on the charter's contents, urged ASEAN to abandon its doctrines of consensus and non-interference in members' internal affairs. To make progress and remain relevant in the face of the rise of China and India, they said, ASEAN must introduce voting on some issues and contemplate punishing countries that did not comply with its decisions. All this would be a huge departure from ASEAN's habit of making grandiloquent declarations about unity but not following them up. Already, the backsliding has begun: the foreign ministers reportedly scratched the proposals for voting and sanctions from the draft charter they will forward to November's summit.

When it first got going, with just five members (Indonesia, Malaysia, the Philippines, Thailand and Singapore), ASEAN seemed important. It was the height of the cold war and the West regarded it as a bulwark against communism. It was also a useful mechanism to avoid wars between the member countries themselves. It was only a year since Indonesia had ended its policy of *konfrontasi* (confrontation) with Malaysia over their shared island of Borneo. Only two years earlier, Singapore had been expelled from the Malaysian federation. The Philippines was still pressing its claim to some of Malaysia's bits of Borneo.

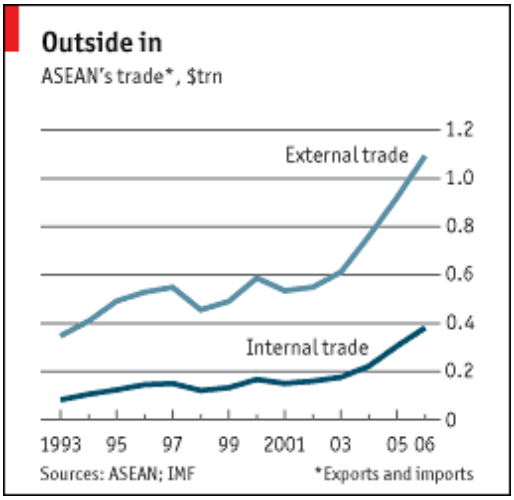
In its glory years, before the 1997 Asian economic crisis, ASEAN's boom generated the sort of worldwide excitement that the booms in China and India do nowadays. However, in that year ASEAN made a decision that looked unwise then and seems even more so now: to admit Myanmar. The other members still argue that “constructive engagement” with Myanmar's nasty regime should work better than the West's sanctions and isolation. It has not—all it has done, in concert with Indian and Chinese links with Myanmar's junta, is help cancel out any pressure it might have felt from the Western approach. ASEAN's failure to win any concessions from Myanmar has badly tarnished its credibility.

ASEAN's overall progress has been modest. For 15 years it has been phasing in a supposed free-trade zone. But this remains riddled with exemptions, special cases and non-tariff barriers. Trade within the block grew by 129% in 2000-06. Nevertheless, ASEAN countries still do three-quarters of their trade with non-members (see chart).

Whereas the EU has exclusive rights to strike trade deals on behalf of its members, ASEAN's progress in negotiating as a block has been limited. It has agreed free-trade pacts with China and South Korea (though Thailand has opted out of the latter because it excludes trade in rice). But a proposed pact with Australia is

behind schedule, prompting Indonesia to announce shortly before this week's summit that it was exploring a bilateral trade deal. Negotiating via ASEAN is so bothersome that other ASEAN members also continue actively seeking bilateral deals.

For all its faults, the EU has achieved economic integration: through its members' willingness to pool sovereignty in important policy areas; by creating a powerful central bureaucracy to enforce the block's laws; and through huge aid transfers from richer to poorer members. ASEAN's "eminent persons" say it must move towards all three of these goals. But the block's leaders lack the political maturity to take such bold steps, so a future of irrelevance beckons. America's secretary of state, Condoleezza Rice, was invited to meet the ASEAN ministers this week but found pressing business elsewhere. George Bush, likewise, has cancelled plans to drop by the summit in November.



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The Khmer Rouge trials

Better late than never

Aug 2nd 2007 | BANGKOK
From The Economist print edition

After years of frustrating delay, the first of Pol Pot's henchmen is charged

Get article background

DEATH allowed Pol Pot and his military chief, Ta Mok, to cheat earthly justice for the enormities of their Khmer Rouge regime. But at last there seems, after years of delay, a real prospect of bringing to trial ageing survivors from the ghastly regime's top ranks. On July 31st judges at a United Nations-backed tribunal in Phnom Penh brought the first charges, of crimes against humanity, against Kang Kek Ieu, alias Duch, who ran Tuol Sleng, the regime's interrogation and torture centre in Cambodia's capital.

True to the stereotype of the coldly meticulous death-camp guard, Duch is said to have kept detailed notes of his work, which may now be used as evidence. Just as predictably, the defendant, now in his sixties and a born-again Christian, insists he was simply obeying orders. Prosecutors hope charges will also soon be brought against four other Khmer Rouge leaders.

Some Khmer Rouge figures have been living in tranquil liberty since reaching an accord in the 1990s with Hun Sen, Cambodia's long-serving prime minister. He was himself a lesser figure in the Khmers Rouges. But there is not thought to be any evidence linking him to the crimes of their 1975-78 reign of terror, when perhaps a quarter of the country's people were either slaughtered or died of starvation or exhaustion. The prime minister rejects accusations of obstructing the tribunal, and insists he is keen for the trials to go ahead.

Ten years have passed since Cambodia first asked the UN for help in creating a special court. In 2003, after years of haggling over how much control the UN would have over it, agreement was reached to create an unusual hybrid. Unlike previous tribunals, such as those for Sierra Leone and the former Yugoslavia, the “Extraordinary Chambers in the Courts of Cambodia” has a majority of local judges. The judges and prosecutors were sworn in last year, but there ensued months of arguing over such things as court procedures and the swingeing fees that Cambodia's Bar Association wanted to charge foreign lawyers taking part in the proceedings.

The prosecutors have compiled thousands of pages of evidence including statements from hundreds of witnesses. They are expected to argue that the Khmers Rouges' mass slaughter amounted to genocide—and indeed the Cambodian government uses Tuol Sleng, now a grisly tourist attraction, as a “genocide museum”. But this will prove contentious, since the regime's fanatical Maoists mostly killed members of their own race. If nothing else goes wrong, trials could begin next year. But if they drag on or prove unexpectedly complex, the tribunal's $56m budget may prove insufficient, prompting further rows over money and perhaps yet more delays in bringing justice to the few senior members of the regime still alive.

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Korean Christians and the Taliban

A clash of faiths

Aug 2nd 2007
From The Economist print edition

Held hostage in God's name

“GOD'S work has to be carried out, at any cost, even death.” Such was the Taliban's grim justification behind the murder this week of a second of the 23 Christian-Korean aid workers kidnapped last month en route from Kabul to Kandahar. The weeks since their abduction have brought unmet demands, a papal plea, a botched hostage release and an emotional appeal from the hostages' relations to the American embassy in Seoul. On August 1st the latest deadline set for the Afghan government passed, without the release demanded by the hostage-takers of their jailed comrades. There were rumours of prisoner exchanges, ransoms and renewed rescue operations.

The Koreans, too, thought they were doing God's work. The South Korean government vehemently denies that Pastor Bae Hyung-kyu, whose bullet-ridden body was found on July 25th, and his flock were engaged in any form of evangelical or missionary work. But the Taliban say they were. Most Afghans have long followed a conservative interpretation of Islam. Polished toenails might now peek out from burqas on Kabul streets, but the Afghan public continues to challenge any slight against Islam. Even the appearance of proselytising Christianity is enough to foment widespread rancour.

Reuters

Set our people free

Mr Bae and his mostly-female missionary group are affiliated with a Presbyterian congregation found in the affluent suburbs of Seoul. Initially embraced in the early 20th century as a means of asserting Korean identity against Shinto Japan and Buddhist China, Christianity is now a symbol of status, and, along with capitalism and democracy, part of an ideological trinity enthusiastically adopted from the West. By 1995 Christianity had surpassed Buddhism as South Korea's most popular religion. Roh Moo-hyun, the current president, and his two immediate predecessors are all Christians.

In recent years Korea's religious zeal has crossed its borders, sending a flood of salvation to destinations beyond. With roughly 16,000 Christian missionaries abroad, Korea is second only to America when it comes to spreading the gospel. Moreover, inter-church competition for alms goads pastors into one-upmanship, sending their congregations on ever-riskier missions to reap the resulting publicity.

The Korean press has been seized by the crisis in Afghanistan. Broadband is brimming with videos of frightened hostages and unsympathetic citizens admonishing the aid workers for not heeding the government's travel warning. This is not South Korea's first experience with good intentions going disastrously awry. Seven Korean missionaries have been kidnapped in Iraq since 2003.

As South Korea contends with the consequences of its religious fervour, the Taliban will have to question the methods of execution and suicide-bombing they are borrowing from al-Qaeda in Iraq. The Taliban rose to power in 1996 out of the ashes of two consecutive wars—first against the Russians, then amongst foreign-backed warlords. In the process, they brought with them a more ascetic, medieval version of Islam. They gained credit for restoring some degree of order to a society rife with crime and despair following nearly two decades of conflict. But the Taliban have ever since been feared for their bloodthirstiness. An insurgent force depends on the goodwill of those in whose name it fights, and the Taliban's religious credentials are beginning to wear thin. Taliban sympathisers, however many remain, will soon conclude for themselves if God's work is indeed worth death.

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Bollywood baddies

Take Dutt

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From The Economist print edition

A film star gets six years in the clink

AFTER receiving a six-year prison sentence on July 31st, Sanjay Dutt, an Indian film star, begged for bail while he appealed against it. “Sir, I made a mistake,” he said. But the judge said no. Mr Dutt's crime—to have procured two guns from Muslim mobsters who were responsible for bomb attacks in Mumbai in 1993—was serious. Yet he urged Mr Dutt, 48, to return to the silver screen after serving his sentence. “Don't get perturbed,” he said. “You have many years to go and work, like the 'Mackenna's Gold' actor Gregory Peck.”

Reuters

Dutt likes a good shoot-out

Thus ended one of the longest song-and-dances in India's criminal legal history. Mr Dutt was convicted last year, having already spent 16 months in jail. He was acquitted of direct involvement in the bombings, which killed 257 people. They were carried out in 1993 in revenge for the demolition of an ancient mosque in the Hindu holy city of Ayodhya by Hindu fanatics, and subsequent Hindu-Muslim rioting. Some 100 people have been found guilty of the bombing. They have all been sentenced in the past three months, including a dozen to death and 20 to life- imprisonment. But the alleged masterminds of the attacks are still at large. One of them, a Mumbai gangster called Dawood Ibrahim, is alleged by Indian officials to be linked to al-Qaeda and to be hiding in Pakistan.

Despite the bleak immediate outlook, Mr Dutt, who made his name playing tough-guy anti-heroes, is unlikely to find his career much damaged. The son of two of Bollywood's biggest stars, a Hindu-Muslim couple, he has garnered enormous sympathy for his suffering. Many Indians believe his claim that he wanted the guns to protect his family during the riots. Other Bollywood stars express support for Mr Dutt as passionately as their Hollywood peers worry about global warming.

Then again, Bollywood is rather shady. Gangsters and crooked politicians have long laundered ill-gotten money through film productions. Indeed Mr Dutt was investigated over money-laundering allegations in 2001. Other recent Bollywood stars to grace the courts include Monica Bedi, an actress convicted of dealing in fake passports. Her accomplice was another Mumbai gangster, Abu Salem, who delivered the guns to Mr Dutt, and is currently awaiting trial for his alleged part in the 1993 bombings.

An even bigger Bollywood star, Salman Khan, is appealing against two prison sentences of five years and one year for poaching respectively an endangered antelope and two gazelles. A Bollywood film about the case has been scheduled. Mr Khan has also had to battle a four-year-old charge that he recklessly drove his car over five people sleeping on a pavement in Mumbai, killing one of them.

Bollywood's biggest star, Amitabh Bachchan, also known as “the Big B”, is, in contrast, venerated. Where Mr Khan is vain and brash, he has a reputation for humility and Hindu piety. But even this has been imperilled of late by revelations that Mr Bachchan and his film-star son, Abhishek, bought valuable plots of

land reserved for farmers. They registered themselves thus after being allotted farmland by a former government of the state of Uttar Pradesh, led by the Samajwadi party. Mr Bachchan is close to one of the party's leading lights, Amar Singh, a famed socialite. Mr Bachchan's wife, Jaya, an actress, is now also a Samajwadi politician.

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America in the Middle East

Arming its friends and talking peace

Aug 2nd 2007 | CAIRO AND JERUSALEM
From The Economist print edition

Claudio Munoz

In short, a new sort of cold war stalks the region

WITH America determined to thwart Iran's possibly nuclear-tipped ambitions, and the Islamic Republic set on blocking the superpower's regional sway, some are calling the contest between Iran and the United States a new cold war. As in the last one, the adversaries have mostly shied from hitting each other directly, preferring propaganda, proxy fighters and subtler pressures. In contrast to the last one, America has so far fared badly. Its burden in Iraq refuses to lighten, and its strategy of pacifying the region by (vainly) encouraging the Arabs to democratise has alienated allies almost as much as its support for Israel. Meanwhile, Iran is enriching uranium in defiance of the UN Security Council and basking in the reflected glory of its clients, Hizbullah in Lebanon, Hamas in Palestine and Shia militias in Iraq.

The beleaguered Bush administration, looking for a comeback strategy, has now reverted to more traditional ways of rallying its friends. What appears to be a charm offensive began with President Bush's call, in mid-July, for a regional peace meeting to address the Arab-Israeli conflict. Arab leaders had long demanded such an event, both to placate their restless publics and to undercut Iran, which is working hard to exploit the Palestinian cause to bolster its image as a protector of Muslim rights. Whether the meeting, expected late this year, can achieve a real breakthrough in the peace process remains to be seen. But at least the Bush administration is showing signs of engagement.

This week America's secretaries of state and defence kicked off an unusual joint tour of the region with a still more concrete show of commitment to American allies. Over the coming decade, officials announced, America would be supplying them with some $63 billion worth of arms. The package included a 25% increase in military aid to Israel, raising its value from $2.4 billion a year to $3 billion, and a ten-year pledge to continue bolstering Egypt's military with an annual $1.3 billion in aid. More controversially, at least in the American Congress, the deal also included a planned $20 billion in weapons sales to Saudi Arabia and the five smaller monarchies that face Iran across the Persian Gulf.

The planned arms transfers, say analysts, are intended to signal that America expects to maintain its role as a guarantor of regional stability, even in the event of a withdrawal from Iraq. Yet, with the exception of the sharp rise in aid to Israel, the big numbers do not amount to much that is really new. America has maintained the same level of military aid to Egypt since 1979, when Anwar Sadat signed the Camp David

peace accords with Israel. In fact, the new commitment marks the end of an unwritten rule that divided American military aid to the peace partners by a 2:3 ratio in Israel's favour. Egypt's share will now shrink to two-fifths of Israel's, leaving aside what the Israeli prime minister, Ehud Olmert, describes as a "detailed and explicit" promise to maintain the qualitative edge in military technology that Israel has traditionally held over Arab neighbours. And in any case, Congress has moved to condition a slice of aid to Egypt this year on improvements in the country's human-rights record.

As for the Gulf, the announcement of $20 billion in promised arms sales over ten years is plainly intended to scare, or deter, Iran. The sum falls far short of what the Gulf monarchies would likely have spent anyway. From 1990-2000, for instance, Saudi Arabia bought some $40 billion-worth of American military gear. Last year alone, the six Gulf Co-operation Council countries signed defence contracts worth more than $20 billion, half of them with American suppliers.

Even so, and despite the fact that Israeli officials say they do not oppose the sale, objections have been raised in the American Congress. Some legislators accuse Saudi Arabia, in particular, of "tacit approval" for Islamist terrorism. But American qualms about the kingdom go beyond point-scoring local politics. Zalmay Khalilzad, America's representative to the United Nations, recently hinted that Saudi support for some Sunni political parties in Iraq has weakened the Shia-dominated, American-backed government. American press reports assert that Saudi nationals make up the single largest group of suicide bombers in Iraq.

In fact, America's relations with its Arab allies have been increasingly strained. In March King Abdullah of Saudi Arabia raised eyebrows by describing America's occupation of Iraq as illegal, and later refused to meet the Iraqi prime minister, Nuri al-Maliki. Despite American prompting to take a more forceful stance, Gulf leaders have kept their serious worries about Iran's ambitions mostly quiet. Egypt's president, Hosni Mubarak, once a frequent visitor, has avoided Washington in recent years. He has also ignored American protests over human-rights abuses. On the day he met with Robert Gates, America's defence secretary, and Condoleezza Rice, the secretary of state, an Egyptian court rejected an appeal to release Ayman Nour, a politician who challenged Mr Mubarak in the 2005 elections, from prison on medical grounds.

One thing that could transform America's standing in the region would be real progress towards George Bush's newly re-iterated "vision" of a Palestinian state. Hoping that getting talks started will increase support for Mahmoud Abbas, the Palestinian president, against the Islamists of Hamas who now run the Gaza Strip, the Bush administration is calling for an international "meeting" in the autumn.

American officials have been avoiding the weightier word "conference" used by their Arab allies, leading observers to suspect that this will end up merely as a high-profile session of the regular confab for the Palestinians' international donors. But an announcement this week that Saudi Arabia might attend could spur something more serious. The Saudi-brokered coalition between Hamas and Mr Abbas's Fatah party earlier this year, though short-lived, went against the preference in America and Israel (and sections of Fatah) for squeezing Hamas out of power. If the Saudis are now readier to co-operate with the American game, it may be a sign that those arms sales are doing their work. And it would serve the interests of both countries by helping to spoil Iran's pose as a defender of the Palestinians.

Diplomacy in slow motion

Mr Olmert has not said that Israel will attend, only that he hopes many other Arab countries do. That could be seen as kicking the ball back in the Arabs' court. Israel has so far refused to accept the Arab League's peace initiative, which calls for full normalisation only if Israel withdraws completely from the West Bank and recognises the right Palestinian refugees claim to return to homes now in Israel. But in recent weeks Israeli officials have once again been talking about removing settlements from large parts of the West Bank, the proposal on which Mr Olmert was elected, but which has been a political taboo since last summer's war in Lebanon.

Things seem to be moving—but glacially. So it is perhaps small wonder that Iran and its allies appear unshaken by America's latest moves. Syria's foreign minister, Walid Muallem, said of the proposed arms transfers that supplying weapons was an odd way to achieve peace. One Tehran daily, *Jomhuri Islami*, dismissed America's diplomacy as being as "useless as a chocolate teapot".

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Iraq

A winning goal, then back to war

Aug 2nd 2007
From The Economist print edition

The euphoria of a footballing victory faded fast

Get article background

JUST when it looks as if salvaging a unified Iraq will be hopeless, there comes a reminder of how strongly many Iraqis still want to live together in a single nation. Iraq's 1-0 victory over Saudi Arabia in the final game of the Asian Cup in Jakarta on July 29th set off a wave of celebrations. Fans ignored the danger of car bombs (which had killed 50 after the Iraqi victory in the semi-finals) as well as the risk of falling bullets (fired into the air to celebrate despite a ban) and poured onto the streets. After the semi-finals, crowds waved the Iraqi flag in the northern city of Arbil, where it is normally denounced by the Kurds as the symbol of the army which waged genocidal war against them. And children in the militantly Shia Baghdad slum of Sadr City chanted the name of Younis Mahmoud, the striker whose goal won the game and who is a Sunni.

Such outpourings of Iraqi nationalism are rare, but they happen. Often they follow a tragedy, such as when Sunnis risked their lives diving into the Tigris to save hundreds of Shia pilgrims who fell into the river after the collapse of a bridge in 2005. At other times they act to prevent a tragedy, such as when Shia clerics called on their followers, apparently successfully, not to retaliate against innocent Sunnis after the second bombing of the al-Askari shine in Samarra in June of this year. Iraqis will also occasionally speak of smaller, more private acts of national unity, such as Sunnis caring for their Shia neighbours' houses after the latter have been run out of them by insurgents.

In honour of the win, the Sunnis' main coalition, the Iraqi Consensus Front, put off a decision on whether to withdraw from the Shia-led government, so as not to spoil the day's joy. A lovely sentiment. But on August 1st it decided—and it withdrew.

The footballing victory has therefore done little to overcome a political deadlock that has stymied proposed legislation on oil sharing and a partial roll-back of the purge that threw many members of the former ruling Baath party out of their jobs. The glow of sporting glory faded further when Iraq's parliament announced that in spite of the continuing strife it would take a month's break in August. And on the first day of that month the bombers were back. More than 60 people were killed in two bombings in Baghdad.

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Conserving Damascus

A road that is not straight

Aug 2nd 2007 | DAMASCUS
From The Economist print edition

Worries about modernising one of the Arabs' oldest cities

Get article background

THOUSANDS of Damascene shopkeepers and residents are waiting anxiously to learn the fate of their endangered community. A plan to bulldoze two ancient districts just outside the city's northern gates to build an eight-lane motorway flanked by high-rise blocks skirting the city wall may, for the moment, have been held up. But many locals still face eviction orders and have been offered meagre compensation. Both businessmen and conservationists fear that the bulldozers may soon roll in.

Much of Damascus is getting a facelift as the city is spruced up to celebrate its designation as the “Arab cultural capital” for 2008 by the cultural arm of the Organisation of the Islamic Conference, a club of Muslim countries. Syrians have welcomed a burst of architectural restoration across the country. But they are worried that the proposed motorway, running between the Bab al-Salaam and the Bab Touma, two of the city's old gates, may threaten the city's hoped-for cultural renaissance.

Officials argue that the road should make it easier to get into the old city and lessen traffic inside its walls. But critics say that many of the buildings in the medieval suburb outside the walls are as old as those within.

Public protest in Syria is risky. But opponents of the plan have posted criticism online in a “Save Old Damascus” petition. “While Baghdad is being destroyed by war,” writes one Dalia al-Jabri, a Damascus resident, “are we to see Damascus destroyed by vested interests?” The conservationists got a fillip earlier this year when the UN's Educational, Scientific and Cultural Organisation (UNESCO) declared that the proposed road project might jeopardise the city's listing as a World Heritage Site, an honour bestowed on it in 1979.

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Punishing apartheid's crimes

If it happened it wasn't me

Aug 2nd 2007 | JOHANNESBURG
From The Economist print edition

A court case reopens old wounds

Get article background

THE Truth and Reconciliation Commission (TRC) closed its doors years ago, but South Africa's painful past keeps on returning to unsettle a country that likes to look determinedly forward. Adriaan Vlok, a former security minister under apartheid, and Johann van der Merwe, a police chief under the old regime, are facing charges for the attempted murder in 1989 of Reverend Frank Chikane, now a senior official in President Thabo Mbeki's office. The pair received amnesty from the TRC for other crimes but did not admit at the time to giving the orders to have Mr Chikane's underwear laced with poison, which almost killed him.

Last year, a remorseful Mr Vlok washed Mr Chikane's feet in a very public display of contrition. Nonetheless Messrs Vlok and van der Merwe are due in court on August 17th. The case has fuelled speculation over whether other apartheid apparatchiks might follow them and heated up a debate over whether political crimes should still be prosecuted.

The TRC was set up in 1995 to ease South Africa's peaceful transition to democracy and encourage reconciliation by shedding some light on the atrocities committed during apartheid. For a limited period, the TRC offered amnesty for crimes committed both by the apartheid regime and the liberation movements, on the condition that the perpetrators disclosed fully all the relevant facts and demonstrated that their actions were politically motivated. Many were turned down. Others argued that the TRC was biased and refused to come forward. So the TRC left many questions unanswered, and several hundred cases were transferred to the National Prosecuting Authority (NPA) when the commission wrapped up in 2001.

Some of apartheid's foot-soldiers complain that they are merely paying for the sins of their bosses. Eugene de Kock, who headed the infamous Vlakplaas hit squad and appeared in front of the TRC, has accused F.W. de Klerk, the last apartheid president, who negotiated the political transition with the now-ruling African National Congress (ANC), of having blood on his hands. Known as “prime evil” and serving a 212-year sentence at a maximum-security prison, the former policeman, famous for niceties such as bludgeoning a prisoner to death with a snooker cue, has approached the NPA, presumably to spill some beans. There has been speculation over whether Messrs Vlok and van der Merwe will now do so as well.

The former president, who was awarded the Nobel Peace Prize together with Nelson Mandela for his role in dismantling apartheid, insists that he committed no crimes and that, if gross human-rights violations occurred on his watch, they were the actions of a few individuals, not part of a policy from on high. Howard Varney, a human-rights lawyer who headed an investigation into covert security operations, retorts that although Mr de Klerk may not have issued direct orders, he must have known what was going on.

More generally, South Africa is divided over whether it should still be prosecuting political crimes committed under apartheid at all, or whether it is time to move on. The ANC is in favour of prosecuting outstanding cases, and Mr Mbeki has rejected outright a proposal from the opposition Democratic Alliance to create a multi-party task-force to stop investigations and prosecutions dragging on. On the other hand, Dirk van Eck, who lost his wife and two children to an ANC landmine in 1985, and AfriForum, a civil-rights group affiliated to the predominantly white Solidarity trade union, would prefer all such prosecutions to stop at once. But they also say that if apartheid leaders are to be prosecuted, then ANC leaders should be too.

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Sierra Leone

As you were

Aug 2nd 2007 | FREETOWN
From The Economist print edition

Peace, and now elections. But not much else to brag about

Get article background

AT LEAST the presidential and parliamentary elections on August 11th will be the first to be held without the help of international peacekeepers since the end of the civil war that lashed Sierra Leone from 1991 to 2002. That is one welcome sign of progress. And since a British military intervention ended the conflict the country's 6m people no longer run the risk of sudden death at the hands of drugged-up child soldiers.

But, five years of peace and hundreds of millions of dollars of aid money later, the issues that gave rise to the war in the first place are still as much in evidence as ever. And the elections, unfortunately, are not expected to change that.

Unemployment is close to 80%, poverty is widespread and corruption endemic. Any reform and improvement in daily life remain painfully slow. There are 300,000 more children in primary school than during the war, a few more paved roads and some electricity, but seven out of ten people still live on less than a dollar a day. The country has the highest infant and maternal mortality rates in the world.

Where reform has been successful it has been led by foreigners. Take the army. Ill-disciplined soldiers looking to get rich with “blood diamonds” contributed mightily to the mayhem of the civil war. But since 2002 the army has been re-trained by Britain, the former colonial power. The army has been shrinking, but as one officer notes, “Every soldier we chuck out of the army is one more man unemployed and on the streets.”

Now that President Ahmed Tejan Kabbah of the Sierra Leone People's Party (SLPP) is standing down after two forgettable five-year terms, it would be reasonable to expect an injection of new faces and energy into the country's politics. But this will not be the case.

Seven parties are contesting the elections, but only three count: the ruling SLPP, its traditional opponent, the All People's Congress, which ruled for 14 venal years under Siaka Stevens, and the new People's Movement for Democratic Change. This split from the SLPP and competes for the same ethnic heartland among the Mende people of the south and east. Since it is run by Charles Margai, nephew of the first prime minister and son of its second, there is little danger of new brooms sweeping through Freetown's shabby corridors of power.

The 69-year old presidential front-runner, Solomon Berewa, is the incumbent vice-president, renowned as a clever and cunning political operator. Some say he has been the real power behind the throne for years. He prefers to describe himself as a man with a proven track record. His critics say he is implicated in all of the current government's failures and shortcomings. “The problem”, says one, “is a small clique running corrupt patronage networks while providing zero services and Berewa will simply embed those networks.”

Stark evidence of what can be done with the right leader in charge comes from across the border in Liberia where Ellen Johnson-Sirleaf is in her second year as president. She has tackled poor governance head-on, firing corrupt officials and removing ghost workers from the payroll. By contrast Sierra Leone's Anti-Corruption Commission is now a lame duck, having had its $2m annual funding suspended by exasperated British donors unhappy with the lack of progress. The replacement last year of an energetic former civil servant by the president's brother-in-law as head of the commission strengthened the perception that the government is not serious about tackling corruption. In fact, most agree, it is growing.

The argument goes that the terrible violence of the conflict is so recent and memories so raw that a

return to war is unthinkable. But many people in Sierra Leone know only violence as a way to vent their frustration at a government that fails them time and again. With the arrival of peace this is no longer a failed state. It may, however, be a failing one.

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Eritrea

Nice new friends

Aug 2nd 2007 | ASMARA
From The Economist print edition

Once a pin-up, now a rogue, and in search of some fresh alliances

SIPPING cappuccino in certain cafés in Eritrea's Art Deco-studded capital, Asmara, you are more than likely to find yourself sitting next to a rebel. He may hail from Sudan's east or from the embattled Darfur region, from Somalia, Ethiopia or several other places. Eritrea is not only a welcoming host; it has been accused of giving rebels arms. This has annoyed its neighbours as well as the West. Yet Eritrea's reclusive, authoritarian government is less isolated than it might have been.

Eritrea was once something of a Western pin-up boy in the new world order. It emerged from its independence struggle against Ethiopia in 1993 with strong international support and lots of political capital. President Issaias Afwerki was named a “renaissance African leader” by President Bill Clinton. But, 14 years after independence, the West now sees Eritrea more as a rogue nation.

It has always given refuge to dissident groups; its government says it supports only peaceful opposition. Western diplomats, however, eye Eritrea's role in the region more warily, seeing it increasingly as a destabilising force. For instance, it helped arm the Islamist militias that took over Somalia last year and were then crushed by Eritrea's arch-enemy, Ethiopia. A UN report last week accused Eritrea of sending “massive” amounts of arms to a jihadist militia in Somalia. Eritrea's primary aim in Somalia is to strain Ethiopia's army; its long-running border dispute with Ethiopia still festers and could break into war again at any time.

Two months ago the European Union said it would engage with Eritrea to solve conflicts in the Horn, but a number of Western governments are becoming more hostile towards it. Eritrea has got used to surviving without Western support. Eritreans say that every time it has mattered, the West has let them down. They are particularly frustrated by the West's inability to make Ethiopia accept the verdict of international arbiters over the border dispute, which led to at least 70,000 deaths in a war from 1998-2000.

Instead, Eritrea's government has been cultivating ties with such countries as Sudan, Libya, China and a handful in the Middle East. Some are old allies who helped Eritrea in its war of independence; now they prop up a dismal economy—and give diplomatic help. “The deepening of diplomatic relations in an easterly direction has given Eritrea breathing room,” says a Western diplomat. “And it's been very cleverly done.”

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Energy in Germany

Nuclear fallout

Aug 2nd 2007 | BERLIN
From The Economist print edition

EPA

Two accidents heat up the debate over whether to revive nuclear power to fight climate change

UNTIL recently, nuclear power seemed to be making its way back into public favour in Germany. A warm winter, and dire warnings by scientists about climate change, convinced many that carbon emissions might be a bigger danger than nuclear accidents or radioactive waste. Opinion polls this spring showed that fewer than half of Germans favoured continuing the policy, adopted in 2000, of phasing out all nuclear plants by 2021.

About a quarter of Germany's electricity still comes from nuclear reactors, and the country's four big power companies had dared to hope for a reprieve for nuclear power—at least to extend the life of existing reactors, if not permission to build new ones. But that changed at the end of June, when two separate accidents at nuclear plants operated by Vattenfall, a Swedish company, in the northern state of Schleswig-Holstein, set back the pro-nuclear lobby once again.

The mishaps—a short-circuit at the Brunsbüttel plant and a transformer fire at the Krümmel station—posed little threat. But Vattenfall botched its public relations (and later sacked its German boss), while environmentalists gave warning that the accidents could have been much worse. Public support for the nuclear phase-out climbed back over 50%.

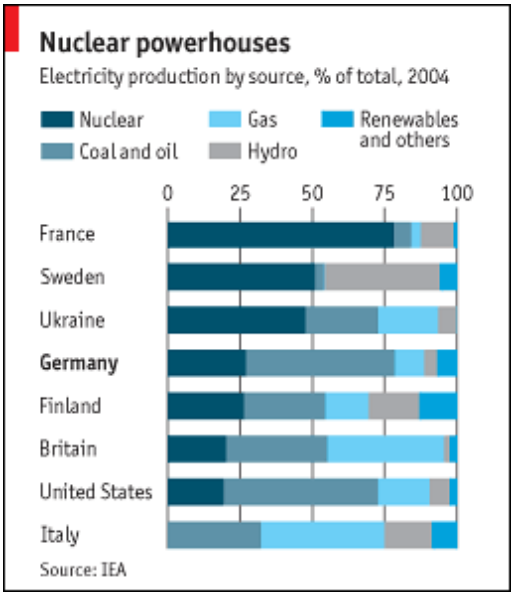
This presents Germany with a dilemma. The chancellor, Angela Merkel, a physicist who in the past helped negotiate the Kyoto Protocol, is a strong campaigner against climate change and wants Germany to set an example. By 2020 the country aims to emit 40% less greenhouse gas than it did in 1990, exceeding the ambitious 30% reduction set by the European Union. But her “grand coalition” is divided over how to do it. Ms Merkel's Christian Democratic Union (CDU) wants nuclear power plants, which do not emit carbon dioxide, to run beyond the deadline, buying extra time for the introduction of greener energy. No way, say the Social Democrats, the CDU's reluctant partners. Their role in approving the nuclear phase-out is one of their few strong political cards. Sigmar Gabriel, the Social Democratic environment minister, insists that energy conservation and renewables can make up for the loss of nuclear power.

Germany's decision will be watched closely elsewhere in Europe, where similar debates are taking place. France remains committed to nuclear power, which provides nearly four-fifths of its electricity, and exports both electricity and nuclear-power reactors. Italy has given up nuclear power (but has interests in foreign nuclear plants). Sweden voted to phase it out by 2010 but is having second thoughts. Finland sees nuclear power as an attractive alternative to fossil fuels, while Britain is thinking of building new nuclear plants.

Germany's aversion to nuclear power may run counter to its desire for both cheap electricity and security of supplies. It is set to replace half its ageing power stations (nuclear and conventional) over the next 15 years. Ms Merkel has presided over three “energy summits”, the last one in July, but there is still no clear idea of how to fill the gap left by the nuclear phase-out.

The environment ministry, created after the 1986 Chernobyl nuclear disaster, has many ideas. Seeking to boost Germany's energy efficiency by 3% a year, it proposes offering tax incentives to modernise buildings and imposing road tolls not only on heavy vehicles but also on light trucks. It wants to tweak subsidies for renewable energy, which already cost consumers some €4 billion ($5.5 billion) a year. Solar energy (not much use in cloudy Germany) would get less, while offshore wind power would get more.

Only the most stubborn optimists think this will be enough. The efficiency target looks unrealistic. Renewable energy, which already generates an impressive 13% of German electricity, will grow either slowly or at great cost. That leaves unpleasant options. Gas is relatively clean, but it is expensive and its main supplier, Russia, has alarmed European countries by periodically choking off oil and gas supplies to those (such as Ukraine and Belarus) that fall out of favour.



The great temptation is therefore to revert to coal, which is cheap, abundant in Germany and, at least until carbon-storage technology is ready, bad for global warming. Ms Merkel has so far done too little to resist its lure. Indeed, Germany subsidises new coal plants by granting them extra permits under the European Union's emissions trading scheme. Around 40 coal-fired generators are being planned, most of them with no provision for capturing carbon emissions (for example by pumping it underground), says Claudia Kemfert of DIW, a think-tank in Berlin.

But the incentives may change. Mark Lewis, an analyst at Deutsche Bank, argues that the carbon-credit subsidy for coal is likely to be withdrawn when the European Union tightens up emissions targets after 2012, making conventional coal riskier. Could that revive nuclear power yet again? Electricity generating companies are pushing to extend the operation of older nuclear plants, in the hope of keeping them open until the 2009 elections, which might bring in a more nuclear-friendly government.

Critics accuse the firms of profiteering, noting that the plants, whose costs have been largely paid off, generate profits of €1m a day. Some analysts suggest keeping them running and imposing windfall taxes that could be used to promote renewable energy. But most Germans would rather kill nuclear power than milk it.

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Terrorism in Spain

A winning streak for Zapatero

Aug 2nd 2007 | MADRID
From The Economist print edition

How the government benefits from the collapse of a controversial ceasefire

THE Spanish prime minister, José Luis Rodríguez Zapatero, has bounced back with remarkable speed. In May, his Socialist Party narrowly lost municipal elections to the People's Party (PP). But with a general election due early next year, recent polls give the Socialists a renewed lead of 3.5-6.5 percentage points.

What explains the turnaround? Surprisingly, perhaps, the reason appears to be terrorism and the end of a 14-month ceasefire by the Basque separatist movement, ETA. The collapse of Mr Zapatero's attempt to negotiate peace with ETA would normally count as a failure. But now Mr Zapatero's opponents can no longer accuse him of being soft on terrorism by talking to the gunmen.

In the renewed fight against ETA, the government has, moreover, been doing rather well. Apart from a couple of harmless explosions as the Tour de France cycling race passed through the Navarre region, ETA has been unable to inflict much damage since it took up arms again on June 6th. Meanwhile, hardly a week has gone by without the government trumpeting some new arrest or the foiling of another bomb plot.

The latest arrests on July 26th, of ETA's alleged head of logistics and two helpers, brought to at least 18 the number of ETA members rounded up in the past two months. Like many others, Juan Cruz Maiza and his alleged henchmen were detained in France, where ETA's leadership is based but is increasingly harassed by French police. The group has twice abandoned bomb-making equipment (once in a taxi near Torreblanca, in the east, and once in a car near the Portuguese border at Ayamonte, to the south-west) as its members feared being caught.

The end of the ceasefire has robbed the PP of its strongest weapon. It had spent the whole of the ceasefire period angrily denouncing the prime minister for betraying ETA's victims. The PP leader, Mariano Rajoy, beat the same drum at a state-of-the-nation debate before the summer parliamentary break, but to little effect. His demands that Mr Zapatero hand over the minutes of any meetings with ETA did not get far. Polls showed Spaniards felt Mr Zapatero won the debate hands down. “Waving around the ghosts of terrorism no longer brings electoral advantages,” the pro-Zapatero *El País* newspaper noted.

Mr Zapatero has learned the hard way that dealing with terrorists is an unpredictable business. Last December he told Spaniards the peace process was progressing well. A day later ETA set off a bomb that killed two people at Madrid's Barajas airport, in an unequivocal sign that the process was collapsing long before the formal end of the ceasefire. The prime minister is now careful not to sound triumphant. “We are not without risk,” he says. “We must keep working in order to obtain results like those of recent weeks.”

Mr Zapatero knows, too, that a successful terrorist attack can provoke a sharp change of mood in the electorate. His own election in 2004 came immediately after the killing of 191 people on Madrid's commuter trains by Islamist radicals.

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Political scandals in Italy

Courting trouble

Aug 2nd 2007 | ROME
From The Economist print edition

Now magistrates take on the centre-left

WHEN he was in power, Silvio Berlusconi, Italy's ex-prime minister and now opposition leader, complained that the many court cases he faced were the work of communist-sympathising “red” magistrates. Now his left-wing adversaries are coming under legal scrutiny, and some are not behaving much better.

The privileges committee of the Chamber of Deputies, the lower house, was due to vote this week on an application from a Milan judge to use 68 intercepted telephone conversations as evidence in an investigation that may cause the centre-left government embarrassment—or worse. Those involved include a deputy prime minister, Massimo D'Alema, and his party colleague, Piero Fassino, secretary-general of the Left Democrats (DS), heirs to the old Italian Communist Party (PCI).

With no hint of irony, Livia Turco, the health minister and herself a former communist, wondered aloud this week whether there wasn't “a section of the authorities in this country that wants to weaken the ex-PCI element in the Left Democrats”. At the same time Mr Berlusconi's former telecommunications minister, Maurizio Gasparri, said moves by the centre-left to put off the vote until September were an attempt to gain “more time for a campaign to discredit the judiciary”.

The investigation arises from a scandal that forced the resignation in 2005 of the central-bank governor, Antonio Fazio, who was alleged to have schemed to stop Italian banks being taken over by foreign ones. On July 25th prosecutors investigating the failed attempt to block ABN AMRO's acquisition of Banca Antonveneta asked for 68 people, including Mr Fazio, to be indicted on charges that include embezzlement, insider trading and obstructing market regulators.

The allegations against Messrs D'Alema and Fassino, which they vigorously deny, is that they too plotted to thwart a foreign takeover, this time of Banca Nazionale del Lavoro (BNL) by a Spanish bank, BBVA. They supposedly promoted the cause of an under-capitalised Italian insurance firm, Unipol, controlled by co-operatives close to the DS.

In one leaked transcript, whose authenticity has not been contested, Mr Fassino was told by Unipol's chairman, Giovanni Consorte, that he stood a good chance of winning. Mr Fassino allegedly responds: “So then. We're the bosses of a bank,” but then corrects himself, saying “You are the bosses of the bank. I have nothing to do with it.”

The Milan judge, Clementina Forleo, was hitherto loathed by the right for her controversial acquittal in January 2005 of three men accused of recruiting suicide-bombers for Iraq, on the ground that they were “guerrillas” rather than “terrorists”. Now she has upset the left, telling parliament the intercepts show that the two DS leaders were “knowing accomplices in a wide-ranging criminal plan”. Some have accused her of being irredeemably biased against the DS. The justice minister has ordered an inquiry into her actions.

But a few centre-left figures, notably a prominent ex-prosecutor, Antonio Di Pietro, say the process of seeking permission to use intercept evidence against politicians is damaging. Strangely, perhaps, the DS has found an unlikely ally in Mr Berlusconi. He says his party will vote against the use of the transcripts because it opposes, out of principle, “invasive intervention by the state”.

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After Turkey's election

General displeasure

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From The Economist print edition

The army refuses to retreat

Get article background

LESS than a fortnight ago, Sebahat Tuncel, a 32-year-old former nurse, was locked in an Istanbul jail, charged with membership of the separatist Kurdistan Workers' Party (PKK). But she jubilantly walked out after being elected to parliament on July 22nd along with 18 fellow members of the pro-Kurdish Democratic Society Party. Ms Tuncel's newly-acquired parliamentary immunity protects her from further prosecution in a case that rested on her frequent trips to PKK camps in northern Iraq. Ms Tuncel says she was trying to find a missing brother.

It is the first time since the early 1990s that overtly nationalist Kurds have been represented in the 550-member legislature. Their presence incenses the far-right Nationalist Action Party, which took 71 seats (and whose campaign pledges include a promise to execute the captive PKK leader, Abdullah Ocalan).

The Kurdish politicians, some of them lawyers who defended Mr Ocalan in court, have promised to behave. They say they will not address the inaugural session in Kurdish (their predecessors who dared to do so landed in jail). Yet some listed Turkish under “foreign languages” in résumés they submitted to parliament. Worse, none is ready publicly to condemn the PKK, even as the group intensifies its violent campaign in the predominantly Kurdish south-eastern provinces.

Turkey's meddlesome generals, who insist that those who refuse to call themselves Turks are “enemies of the state”, are not happy. Yet, the Kurdish MPs are only a minor irritant compared with the 341 members of the mildly Islamist Justice and Development (AK) Party who romped back to power. Indeed the generals' public accusation that the country was descending towards religious rule—and the implied threat of a coup—probably helped AK increase its share of the vote to 46.7%.

The generals' ire was provoked when the prime minister, Recep Tayyip Erdogan, nominated his foreign minister, Abdullah Gul, to replace the strongly secular president, Ahmet Necdet Sezer, who was supposed to have stepped down in May. This sparked a wave of demonstrations by millions of secular Turks, who shared the army's aversion to Mr Gul's earlier flirtation with political Islam. Many also took issue with his wife's headscarf; the garment is banned in all government buildings and schools.

Mr Gul withdrew his candidacy, and Mr Erdogan called early elections, after the constitutional court upheld opposition claims that a first round of balloting for the presidency had been invalid because parliament lacked a quorum.

Parliament reconvenes on August 4th and must choose a new president by mid-September, or fresh elections will be held. Mr Gul is campaigning for the top post once again, backed by AK's Islamist rump. Mr Erdogan is in a bind. Endorsing Mr Gul puts his government back on a collision course with the army; General Yasar Buyukanit, the chief of general staff, said the army stood by its views (and thus its opposition to Mr Gul) “with conviction”. Yet, if Mr Erdogan bows to the army's demands, he risks splitting his own party.

“Erdogan can block Gul and lose a few MPs, or back him and lose power altogether,” says a seasoned Turkey-watcher. That is, unless Mr Gul bows out.

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Charlemagne

Smoke gets in their eyes

Aug 2nd 2007
From The Economist print edition

Illustration-David Simonds

What this summer's forest fires say about the priorities of EU politicians

EVERYBODY loves a fireman, especially those saviours from the sky who swoop down in yellow-painted Canadair planes and “bomb” fires with six tonnes of water in a single swoop. Not everybody, it is fair to say, loves the European Union. So it is little wonder that every summer, as forest fires crackle and roar across southern Europe, politicians suggest Brussels should make itself more popular by creating an EU fleet of such planes.

Given that the most sought-after models, made by Bombardier of Canada, cost more than €19m ($26m) a pop, it is argued that such precious assets should be shared. Better still, they should be painted with the blue-and-gold European flag so that grateful citizens can see who is zooming to their aid. A 2006 report for the European Commission—warmly welcomed by the European Parliament—argued for the creation of a new civil-protection force, dubbed “EuropeAid”. It suggested buying ten new water bombers as the minimum needed to form a “credible” Euro-squadron (though whether they should be paid for by EU funds or national governments was left unclear).

The author of that report, a former French foreign minister, Michel Barnier, has been at it again. While inspecting fire precautions in southern France on July 26th, in his new capacity as his country's agriculture minister, Mr Barnier renewed his call for a “EuropeAid” force. His boss, the French president, Nicolas Sarkozy, discussed creating “some sort of European fleet” of jointly owned fire planes during a working lunch with the Greek prime minister, Costas Karamanlis. The EU environment commissioner, Stavros Dimas (whose officials would control such a fleet), unsurprisingly found the plan “very encouraging”.

In the face of yearly devastation—only this week, fire damaged a third of the forest cover on the two largest Canary Islands, forcing the evacuation of 14,000 people—the Canadairs offer impressive proof to voters that the authorities are taking the disasters in hand. Specially toughened boat planes, they can attack fires up to nine times an hour, skimming across a nearby lake or sea to fill their tanks in seconds. (According to a popular tale, a Canadair once sucked up a diver by mistake and dropped him, flippers sadly waving, onto a fire. Not true: the water intakes are only inches wide.)

Mr Barnier's report does not conceal the political dimension, saying it is “essential” to make EU assistance more visible. It says there should be a single Euro-uniform worn by “all staff acting as part of the European force”, emblazoned with the EU flag, the flag of the wearer's country and the words “EuropeAid”.

European politicians should resist such temptations. Their ability to do so will say much about whether the EU puts action above spin. There is every sense in helping nations share expensive assets to confront menaces such as forest fires. But the union is already doing just that. The commission runs an excellent unit called the Monitoring and Information Centre (MIC), swiftly linking countries that need emergency equipment with European governments that have planes to lend. Another unsung commission unit, EFFIS, sends out daily forest-fire risk assessments, based on weather forecasts and the like.

There is no reason to suppose that a joint EU squadron would work better. One EU official admits it would be politically “difficult” to decide where to send planes when fires are raging in several countries. Even Canada, a single state, merely encourages provincial governments to share water bombers; it does not direct their movements. As David Martell, a University of Toronto academic, notes: “There is no way political leaders in one jurisdiction are going to allow themselves to be dictated to by somebody else” at such times.

Forestry experts in bodies such as the Food and Agriculture Organisation (FAO) show surprisingly little yearning for big sums to be devoted to water bombers. European governments have spent hugely on new equipment in recent years. Bombardier's records show that there are already 76 Canadairs in service in EU nations, including 36 of the latest type (a 37th crashed in Greece last month, killing its crew). Money might now be better spent on fire prevention. Although the overall area of land burned each season is in decline because of better fire-fighting equipment, the number of blazes in EU forests keeps rising.

The poor shepherd

Researchers point to several reasons, few of which can be resolved by water-bombing. Important factors include rural depopulation, growing wealth, arson and stupidity. Once people can afford gas cookers, and stop herding goats, firewood gets left on the ground and flammable scrub is left uncleared. The last, elderly shepherds start fires to clear thorny scrub and to promote green-shoot growth, “but they lack the physical strength or the manpower to control a fire, and it gets out of hand,” says Pieter Van Lierop, a forest-fires expert at the FAO. Climate change plays a role, and so do dimwits (cigarette butts start many fires).

Governments talk a lot about arson, especially by property speculators trying to build on forest land. Many Mediterranean states have laws against building on burned forest land (under a 2006 Spanish law, land use cannot be changed for 30 years after a forest fire). Corruption, and weak or clogged legal systems, can undermine such rules, of course. Part-time firemen sometimes set fires to generate work for themselves, a new FAO report notes. A local forest ranger is being held in the Canary Islands, accused of just that. But the FAO also suggests that loud talk of arson can be cover for government “ineffectiveness”.

Forestry experts favour rather mundane solutions, like education, making firebreaks and hiring ground crews with spades and hoes. That may please the crowds less than EU-flagged planes piloted by heroes in blue and gold flightsuits. But if politicians want to be loved, they should have chosen another trade: being a fireman, perhaps?

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Correction: Italian pensions

Aug 2nd 2007
From The Economist print edition

Our story about Italian pensions last week should have said the government raised the retirement age in 2004, not 1994. The payments revision was introduced in 1995, not 1994. Sorry.

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Innovation and the economy

The good, the bad and the ugly

Aug 2nd 2007
From The Economist print edition

David Simonds

How Britain rates as a knowledge-based powerhouse

Get article background

IN 1963 Harold Wilson spoke of the “white heat” of the technological revolution. Decades later, innovation and the knowledge-based economy are all the rage. Since June innovation has been enshrined, along with universities and skills, in the formal title of a ministerial department. In 2000 Europe's leaders committed the region to becoming “the most competitive and dynamic knowledge-based economy in the world” by 2010.

Governments have good reason to foster innovation, for it is the mainspring of economic growth. Developing countries can grow quickly by investing heavily in new plant and equipment. But rich nations have already built up big capital stocks. If they are to sustain growth in the years ahead, they must be economic pioneers, pushing out the technological frontier through advances in knowledge.

Britain, which has dismantled its old manufacturing industries faster and further than most, has made an especially big bet on its ability to thrive as a knowledge-based economy. So how innovative is it?

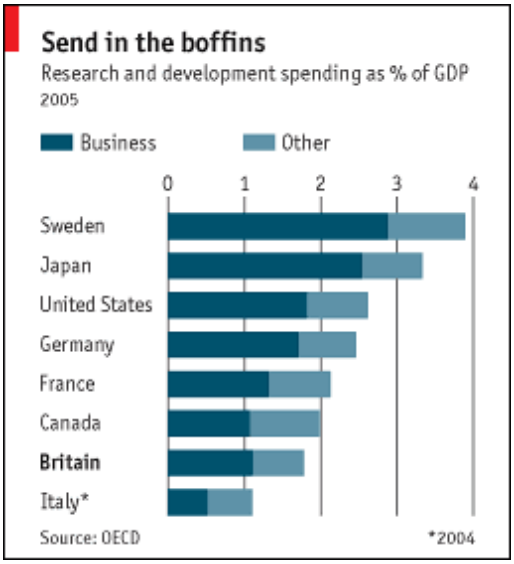
There is no black and white answer, because performance varies according to the gauge that is used. There is a host of plausible measures, ranging from basic scientific work to patents and business research and development, from use of computer software to spending on broader types of knowledge-based activities such as instilling best managerial practice.

Britain undoubtedly scores high in basic scientific work. It undertakes 5% of the world's research and publishes 12% of cited papers. That share of citations places it second, behind America, in a world ranking of research excellence. British scientists claim around 10% of internationally recognised scientific prizes every year.

But what matters for economic innovation is turning scientific discoveries into new products and smart processes. Patents are one guide to this, and on this basis Britain is doing badly. In patents per head that are granted internationally Britain lags behind Japan, America and Germany. And the gap has widened since the mid-1990s.

This disappointing performance reflects a poor record in research and development. Britain spends 1.8% of GDP on R&D, considerably less than many other advanced economies—notably Sweden, which commits

3.9% of national resources (see chart). The main reason for the shortfall is a low contribution from business.



But some of the gap reflects the structure of an economy that has switched a long way from manufacturing to services. This change has tended to bring down business R&D spending in Britain, since manufacturers usually account for the bulk of it. Yet firms in America spend 1.8% of GDP on R&D although manufacturing comprises an even smaller share of their economy than it does in Britain.

Other measures, such as the share of R&D staff in employment, paint a similar picture. In 2005, using a range of conventional indicators, the OECD described Britain's innovation performance as “mediocre” compared with the best countries. An “innovation scoreboard” published by the European Commission in 2007 ranked Britain behind the leaders, a group made up of Sweden, Switzerland, Finland, Denmark, Japan and Germany.

Yet Britain's thriving business and financial services are hardly innovation-free zones. Rocket scientists may be thin on the ground in traditional R&D but investment banks are keen to recruit them to dream up sophisticated financial products. The City of London invests heavily in computer software and is heaving with innovation, notably in derivatives.

Britain also has a big “creative” sector—industries such as advertising, publishing, broadcasting and design. Provisional research by the OECD based on data from five countries suggests that such businesses are more important in Britain, where they account for 5.8% of the economy. Next highest was Canada, at 3.5%, then America, Australia and France, at around 3%. Britain's creative firms are also more innovative than those in other sectors, a government survey found in 2005.

The vitality of these knowledge-based businesses suggests that Britain's performance might look better if innovation were measured more broadly. For example, Britain is a software-savvy country, spending £23 billion ($42 billion) in 2006—worth 1.75% of GDP, one of the higher levels among advanced countries.

Recent research has valued a range of such intangible activities in the business sector of the economy (see article). At present software is the main intangible counted as investment, which adds to GDP. The others are treated as if they are used up, like electricity, in production. Including them all as investment would boost business output by 13%, about the same effect as other research has shown for America.

Since America is commonly regarded as a pretty innovative economy, that is an encouraging result. But Britain's poor record in basic schooling should puncture any premature celebration. A well-educated and highly skilled workforce is vital in adopting new technologies and innovative practices. It is hard to see how Britain can score top marks as a knowledge-based economy as long as so many of its youngsters fail to make the grade.

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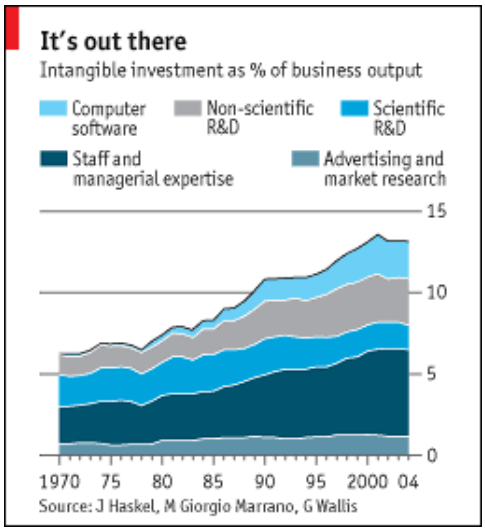
GDP redefined

Intangible measures

Aug 2nd 2007
From The Economist print edition

Counting investments in knowledge reveals a new picture

Get article background



ONE of the main snags in assessing innovation's impact on the economy is that official statistics trail behind the pioneers. The national accounts are good at measuring capital spending on things such as plant and equipment that matter in an industrial economy. They are not up to speed in incorporating investment in intangible activities such as R&D. How far would the existing view of the British economy alter if these were fully included?

"Fairly drastically", says Jonathan Haskel, an economist at Queen Mary, University of London. A recent paper that he wrote with Mauro Giorgio Marrano and Gavin Wallis estimates the value of three broad categories of intangible investment in the business sector of the economy.*

With some minor exceptions, only the first, computer software, is already counted as investment in the national accounts. The second includes both scientific R&D—the traditional kind—and non-scientific research developing, for instance, new designs and financial products. The third is a broader category intended to capture the investments firms make to support their brands and organisational skills. The researchers count some of the money spent on advertising and market research, as well as the budget to train staff and expenditure designed to improve managerial expertise.

The researchers find that for every pound that businesses are investing in physical assets they are spending another building up intangible assets. Furthermore, intangible investment has been increasing faster than the rest of business output (see chart). That pushes up growth in both output and productivity when it is included. As Mr Haskel says, "There's a ton more investment going on and lots more GDP."

The numbers are a first stab at coming up with a broad measure of intangible investment in Britain. They involve a good deal of guesstimation. But even if more reliable figures present roughly the same picture, this will not necessarily enhance Britain's international standing as an innovative economy. Until several more countries have done such studies, Britain's relative performance using this broad gauge of innovation cannot be pinned down, says Dirk Pilat, head of science and technology at the OECD.

In any event it will be some time before official number-crunchers adopt the new approach. At present the only change under way is to treat conventional R&D as investment by 2011.

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* "What Happened to the Knowledge Economy?"

"What Happened to the Knowledge Economy? ICT, Intangible Investment and Britain's Productivity Record Revisited", by Jonathan Haskel, Mauro Giorgio Marrano and Gavin Wallis

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BA and Virgin

Flying in formation

Aug 2nd 2007
From The Economist print edition

It takes two to fix prices

Get article background

FOR years British Airways (BA) described itself as “the world's favourite airline”. It no longer looks so popular in London and Washington. On August 1st the firm was hit with a transatlantic double whammy after it was found guilty of colluding with a rival, Virgin Atlantic, to fix prices on long-haul passenger routes. Britain's Office of Fair Trading (OFT) handed down a record fine of £121.5m ($246m). A few hours later, America's Department of Justice (DoJ) imposed a $300m penalty of its own. The severity of the American fine also reflected BA's role in a different international conspiracy involving Korean Air and Lufthansa.

A clearer example of illegal price-fixing than that between BA and Virgin would be hard to imagine. The two firms discussed “fuel surcharges” at least six times between August 2004 and January 2006, during which time they rose from £5 to £60 on a return ticket. Willie Walsh, BA's chief executive, had admitted guilt as early as October 2006, condemning the anti-competitive behaviour. Two executives, Martin George and Iain Burns (the commercial director and communications chief, respectively) left the firm that same month. More may follow. Although the fines closed the civil case against BA, a criminal investigation is taking place as well, and the OFT refuses to say whether charges will be brought against individuals.

The cartel-busters were exultant. Philip Collins, the OFT's boss, boasted that the large fine would “send an important message...about our intention to enforce the law”. The DoJ was blunter, describing the arrangement as a “conspiracy”.

A transatlantic bust was particularly fitting for the OFT. During Labour's period in office, it has introduced American-style, cartel-busting sanctions on companies that prefer cosy deals with rivals to the bracing winds of competition. But despite many protracted investigations into sectors such as banking and supermarkets that attract consumers' ire, the OFT has struggled to find the kind of smoking-gun evidence of collusion it needed to look as terrifying as it and the government wished. Until this week, the biggest fine it had imposed was the £17m (subsequently reduced on appeal to £15m) levied on Argos, a retailer, for fixing the price of toys with a rival, Littlewoods.

That is partly the nature of the beast. Collusion is difficult to prove: as Mr Collins observes, the tricky thing about colluders is that they do their business in secret. Indeed, the airlines' price-fixing came to light only after Virgin's legal department alerted the authorities.

This was no selfless dedication to consumers' welfare. Virgin hoped to benefit from the “leniency policy”, which was introduced in the 1998 Competition Act and copied from similar laws in America, granting immunity to firms that blow the whistle. Virgin was just as complicit as BA in the price-fixing and has, presumably, benefited from it financially. Not only was the airline saving itself from the risk of prosecution, but it was also grassing up a rival with whom it has had a bruising relationship in the past.

Whether Virgin gets off entirely scot-free is another matter. Along with BA, it will probably have to defend itself in class-action suits by American passengers who claim they were overcharged. And while most of the opprobrium is currently being heaped on BA, Virgin's reputation also looks likely to suffer as the dust settles.

It grates to see one firm get away with something while another is punished, but leniency policies are, probably, a good thing. The ability to claim immunity gives a powerful incentive for businesses to police their own industries, which ought to improve things for consumers. After all, half a victory is better than none.

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The de Menezes shooting

In the aftermath

Aug 2nd 2007
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The first published report of a long-drawn-out inquiry

WHEN the news broke in July 2005 that London's Metropolitan Police had shot dead a suspected terrorist as he boarded an Underground train, there was grim relief. The previous day four terrorists had unsuccessfully tried to blow up three trains and a bus in the capital. A fortnight earlier another group had succeeded with a similar mission, murdering 52 passengers. Yet within 24 hours relief had turned to nausea. The man on the receiving end of eight police bullets was Jean Charles de Menezes, a 27-year-old Brazilian electrician on his way to fit a fire alarm. A Catholic, de Menezes had no links to extremism of any sort.

Two years on, the police have been found not just to have botched the operation but also to have misled the public afterwards. On August 2nd the first published report on the tragedy by the Independent Police Complaints Commission (IPCC) cleared Sir Ian Blair, the head of the Met, of misconduct but said that Andrew Hayman, the force's chief of counter-terrorism, had misled senior colleagues and journalists about the victim's identity in the hours following the shooting. *The Economist* went to press before the officers could respond.

The police's behaviour had already attracted criticism. On the day of the tragedy Sir Ian wrote to the Home Office's permanent secretary arguing that the IPCC (which automatically looks at all fatal police shootings) should not investigate because its report might give away secret counter-terrorist methods. The IPCC went ahead anyway; when details of its report were leaked to the press, police arrested a reporter and his girlfriend in separate dawn raids. This week's report was toned down following legal threats from the officers facing criticism.

It is hard to imagine the anguish of the de Menezes family, who are waiting for an inquest that cannot take place until a legal case against the Met for its handling of the operation is concluded. But dragging out the process could be damaging for the police as well. The more the Met harries the IPCC, the more others will call for the body to be strengthened. Meanwhile Gordon Brown, the prime minister, is trying to convince MPs to give the police new anti-terrorism powers. That was already hard. It will be no easier after this week's reminder that on one occasion officers made a deadly mess with the ones they had, and tried to fudge it afterwards.

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Birth certificates

Misconceived

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Mummy, tell me, where did I come from?

AS ANYONE who adopts a child can tell you, the word “parent” is as much a job description as a biological fact. Still, many adopted children are curious about their origins. In recent years testimony from some who only discovered the truth of their adoption as adults, and resented having been lied to all their lives, has led to a change in attitudes. Almost all parents who adopt now tell their children about it right from the start, and once those children reach 18 they can, if they wish, view their original birth records.

Should parents who conceive using donated eggs or sperm be equally open about their children's genetic origins? A committee of MPs and peers, set up in May to examine planned changes to the law governing fertility treatment, thinks so. On August 1st it recommended that, if a child is conceived using donated eggs or sperm, that fact should be stated on the child's birth certificate.

In 2005 it became illegal to donate eggs or sperm anonymously, and a register of donors was set up for children to consult once they turn 18. It seems unlikely that it will be as effective as the adoption register, because covering up the initial truth is easier. Anecdotal evidence from fertility clinics suggests that many would-be parents have reacted to the bar on anonymity by deciding never to tell their offspring that a donor was involved in their conception. So the committee thinks that the fact of donation should be stated on the birth certificate.

To some, what is at issue is the same as in adoption: a fundamental right to know one's genetic origins. To others, giving sperm or eggs is more analogous to giving blood than to bearing and handing over a baby. Many feel that a mere donor has no meaningful connection with the child who results.

Now that anonymity is no longer possible, there has been a huge decline in the number willing to donate. So more patients travel for treatment to countries where anonymity is still legal. If this new proposal is implemented, it may give such “fertility tourism” a further boost. It may even compound the problem that it purports to solve and encourage parents to reveal still less. But then, when mothers do what some have always done with regard to paternity—conceal the truth when registering the birth—it will be a sin of commission.

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Retail banking

Once more unto the branch

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How revolting customers are changing the economics of British banking

REVOLUTIONS in modern Britain are rare, especially ones by hitherto-docile bank customers. Yet in recent months tens of thousands of long-suffering account holders have risen up. They are demanding the return of penalty fees charged for infractions such as bounced cheques, late payments and unauthorised overdrafts.

Noisy as this cheque-book brigade is, most banks and analysts have dismissed their impact on the banks' bottom lines. But this week HSBC, Britain's biggest bank, said it had had to pay out £116m to complaining customers in the first half of this year, Lloyds TSB revealed payments of £36m, HBOS of £79m and Barclays of £87m. Analysts are now hurriedly ratcheting up their estimates, with most reckoning that banks' payments will total more than £500m from January through June.

As ominous as that sounds, a one-off cost of £500m can easily be absorbed by so profitable an industry. But many bankers worry that their troubles have just begun. The £2 billion-4 billion that banks are thought to garner each year in overdraft penalties looks vulnerable, and so do the billions more they have collected over the past few years.

The issue ultimately hinges on a series of arcane legal questions as to whether such payments are penalties (and thus must be proportionate to the costs incurred) or fees for services (which confusingly either can be limitless or must be “fair”). On July 26 the Office of Fair Trading (OFT), a competition watchdog, said it had agreed to bring a test case against eight banks before the High Court to seek some certainty after a hotchpotch of contradictory rulings in county courts. Although banks have generally argued that their charges (which typically range from about £25 to £50 for overdrafts) are legitimate fees agreed to by their customers, cynics question whether the bankers are indeed so sure of their position, given that most have proved willing to settle claims out of court to avoid a precedent-setting judgment.

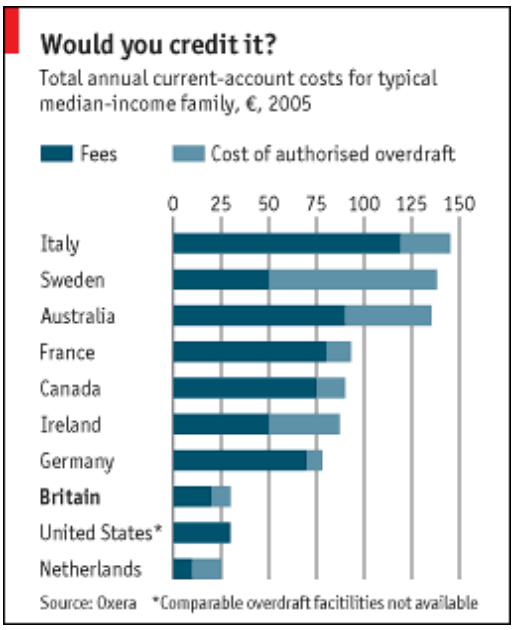
However the court case is decided, the mere fact that it was brought reveals the emergence of two trends that may be changing fundamentally the economics of consumer banking in Britain. The first is that Britain's financial regulators are growing steadily more vehement in championing customers' causes. The shift started when responsibility for overseeing banks was taken away from the Bank of England (which was mainly worried about whether they went bust) in the late 1990s and handed to Financial Services Authority and the OFT. These regulators found two areas of price gouging in recent years—in credit-card charges for missed payments and loan insurance—and took steps that may trim banks' income by about £1.3 billion a year.

A second trend is the rise of the internet, which has not only made prices more transparent but also let consumers collaborate in new ways, thus allowing the upset of a few to become the revolt of the many. Some have set up websites explaining how to draft claims and, if need be, take banks to court; others have collated the outcomes of thousands of claims. Forums, mailing lists and blogs devoted to bank charges have all sprung up in recent months. “I can't think of another concerted consumer campaign on the scale of this one,” says Cavendish Elithorn, a director at the OFT.

The scale of the uprising has taken the banks by surprise. It may also force them to change the way they act. Where once they debated whether a proposed new product or charge was legal, now they worry about whether it might have to be defended in thousands of costly appearances in small-claims courts. One downside to all this consumer activism could be a reduction in innovation if banks withdraw controversial (though often needed) products such as expensive loans for people with poor repayment histories or equity-release mortgages.

A bigger negative, for many, could be that banks decide to start charging more people for more services, and particularly for current accounts that stay in credit. For all the fuss over extortionate charges, the average British customer pays less at present for using his current account than those who bank in almost any other country (see chart). This is largely because of a cross-subsidy from a minority of poorer or disorganised customers who pay penalties for bounced cheques and the like to ones who don't, and from the financially illiterate to the astute.

But if banks' penalty fees are capped, they will look for ways to restore their margins, which have already been squeezed by competition in mortgage lending. Charging monthly fees on current accounts in credit, or steeper fees on cash-machine withdrawals, could well catch on. That may be fairer than the system today, but it will not be popular. “If you have a minority paying the majority, you aren't going to get a vote for change,” says one senior banker. He should know.



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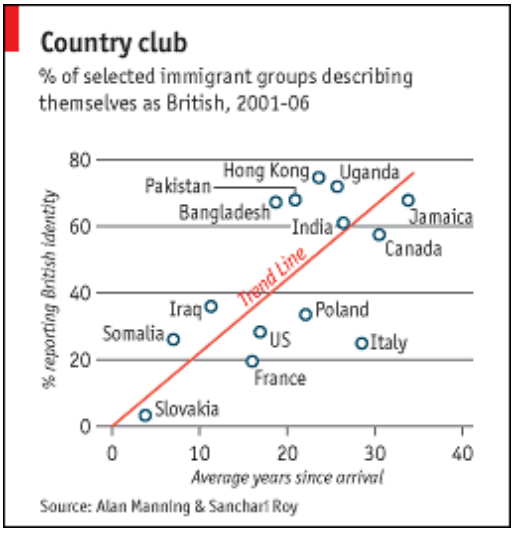
Immigrants and Britishness

Stirring the melting pot

Aug 2nd 2007
From The Economist print edition

Migrants from "problem" countries may fit in faster than most

Get article background



BRITAIN'S 2.6m Asians must spend a lot of their time responding to surveys. Do they approve of terrorism? Should women wear headscarves and veils? Are arranged marriages acceptable? Such questionnaires—many aimed at defining a specifically Muslim cast of mind that might turn to terrorism—have become ever more common since the 2005 London bombings sparked an insatiable interest in ethnic groups and their opinions.

This week the BBC's Asian Network published its own poll, carried out by ICM. Its headline finding was that 38% of young British Asians felt just "a little" or not at all British. This was qualified somewhat by the discovery that 26% of a parallel white group felt the same, probably because proud Scots, Welsh and English nationalists rejected the "British" tag. Nonetheless, the differences were played up—most magnificently by the *Times of India*, which described Britain's "brown citizens" as a "separate nation".

In fact, Asian migrants, and especially the Muslims among them, seem rather more prone than others to feeling British, relative to the length of time they have spent in the country. According to Alan Manning and Sanchari Roy of the London School of Economics, who reworked data from the *Labour Force Survey*, Pakistanis and Bangladeshis are especially apt to describe themselves as British (see chart), though they are commonly thought to be worse than most at fitting in.

One reason for this is that they are more likely than Europeans, for example, to apply for citizenship, since they need it in order to stay and work. Having British citizenship, not surprisingly, makes people more likely to feel British. So Mr Manning and Ms Roy started again, looking only at those who were not yet citizens. The pattern was less pronounced but still present: people from the poorest and least democratic countries were quicker to embrace Britishness than those born in rich, liberal nations. The latter feel they already belong to a "winning side", the authors suggest.

Urgent plans for the assimilation of reluctant Italians, among the least likely migrants to feel British, have yet to materialise. The fact that no-one seems to worry about them reflects the assumption that their values are close to British ones, even if they do not formally join the club. Not all immigrants are granted the same leeway.

Is this justified? In 2005 a YouGov poll of British Muslims for the *Daily Telegraph* found that 24% had at least some "sympathy with the feelings and motives" of that summer's bombers. Yet the same survey found that only 1% supported the use of violence, and just 3% said that they would keep quiet if they suspected someone of hatching a plot. More broadly, Home Office surveys show that both British-born and migrant Asians support almost as strongly as whites basic civic values such as the right (and obligation) to vote.

Where the biggest gap emerges is in what constitutes Britishness for different groups. Interviews by YouGov for the Commission for Racial Equality showed that most ethnic minorities see Britishness as an identity that is defined by values—fair play, the rule of law and so on—whereas white Britons overwhelmingly cite fish and chips, Winston Churchill and other cultural and historical icons. The reason, suggests Peter Kellner of YouGov, is that Britain's values, not its culture, are what attracted migrants in the first place.

Last month the government announced that compulsory school citizenship classes would include work on British values and national identity. A version of Britishness that rests on common norms may be the right sort to teach—but it is the version that most Britons of immigrant stock hold already.

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Drug prescribing

Trial of strength

Aug 2nd 2007
From The Economist print edition

The struggle between those who develop medicines and those who pay

WHAT price an old man's sight? A few extra months for a young mother with terminal breast cancer? Easing the burden of caring for a spouse with dementia? In England and Wales the unenviable task of deciding falls to the National Institute for Health and Clinical Excellence (NICE), which judges the cost-effectiveness of new medicines and decides which the taxpayer should pay for, and for whom.

Set up in 1999 in response to widespread concern that patients in one area were being denied medicines available in another, the agency's Solomonic brief means it is never far from the news. Its decision in 2006 that breast-cancer sufferers must not be made to wait for the disease to progress before being given an expensive drug called Herceptin was challenged by a National Health Service (NHS) trust that wanted also to be told which treatments to cut in order to balance its books. And on August 10th the High Court is to rule on whether NICE was unreasonably stingy in restricting guaranteed funding for Aricept, a treatment for Alzheimer's, only to those patients already showing significant signs of dementia.

One current battle highlights even more starkly the differing interests of those who make drugs and those who use and pay for them. The disease is wet age-related macular degeneration (wet AMD), in which blood vessels grow abnormally and leak into the centre of the retina, damaging sufferers' central vision. The medicine is Lucentis, licensed to treat the condition by the European Commission in March. Its cost is high—around £1,000 for each monthly injection, usually over the space of a year or more. And NICE's decision? That only the most severely affected fifth of the 26,000 new sufferers each year—mostly among the over-50s—should be guaranteed free treatment, and then only for the less-seriously damaged eye.

Patient groups denounce the ruling as heartless: a coalition led by the Royal National Institute of Blind People is fighting to have the criteria relaxed before NICE publishes its final, binding guidance at the end of the year. But an unusual conflict of interest means that Genentech, the drug company that produces Lucentis, is conspicuously silent. Genentech also produces Avastin, a related compound that was licensed to treat bowel cancer in 2004. At as little as £20 for the tiny quantities needed to treat an eye, Avastin can be used as a cheaper treatment for wet AMD.

Avastin works by starving tumours of their blood supply. So when it first came on the market, ophthalmologists hoped it would work the same magic on the abnormal growths in the eyes of wet-AMD sufferers. With no other effective treatment then to offer patients facing blindness, they took to injecting small amounts of Avastin into people's eyes, even though the drug's licence did not cover this use.

The treatment turned out to be not only gratifyingly effective but also cheap. Ironically, NICE could not even consider the product for required use in the NHS because the agency's remit is limited to looking at how well and cheaply drugs work on the patients the drug company intends them for—and Genentech has said, understandably, that it does not intend to apply for a licence to use Avastin for wet AMD.

Tantalised by the prospect of saving the sight of thousands of people on the cheap, the NHS is taking matters into its own hands. Some NHS managers have already announced that they will be treating patients with Avastin: one patient group lists 14 areas in which this treatment is offered. Even more significantly, in the past few days the NHS has signed a contract for a large-scale trial to compare Lucentis and Avastin head-to-head—one of very few such trials that are not funded by pharmaceutical companies.

If Avastin turns out to be an acceptable alternative to the pricey Lucentis, it is sure to become the treatment of choice. Drugs firms naturally want to make as much as possible from their discoveries. Customers, just as naturally, are fighting back.

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A bigger negative, for many, could be that banks decide to start charging more people for more services, and particularly for current accounts that stay in credit. For all the fuss over extortionate charges, the average British customer pays less at present for using his current account than those who bank in almost any other country (see chart). This is largely because of a cross-subsidy from a minority of poorer or disorganised customers who pay penalties for bounced cheques and the like to ones who don't, and from the financially illiterate to the astute.

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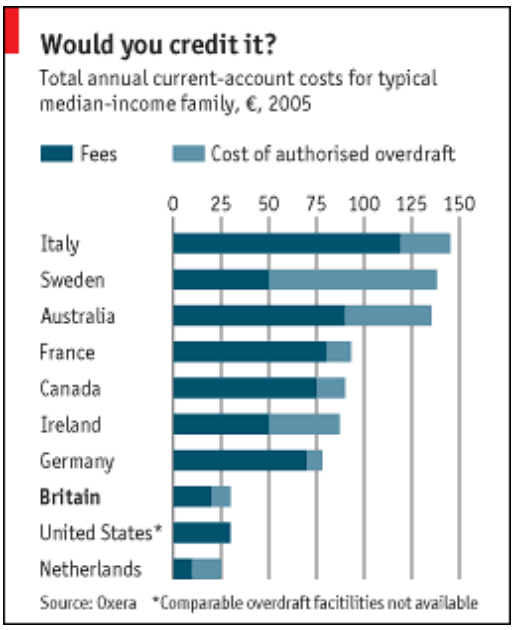

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Bagehot

Doublespeak

Aug 2nd 2007
From The Economist print edition

Steve O'Brien

Gordon Brown told the truth about Britain's relationship with America—both of them

Gordon Brown

WITH his helicopters behind him and what looked like a golf driving-range in front of him, George Bush began his public encounter with Gordon Brown with home advantage. Then he deployed the array of one-upmanship tricks he has honed in office: his stiff-looking guest, Mr Bush said patronisingly, had “proved [his] worthiness as a leader”; in June's botched terrorist attacks he had “got a taste” of the struggle for civilisation that Mr Bush, by implication, was leading. The president casually mocked a British journalist for his baldness and an American one for his youth, and made sure he got the last word. In contrast to this easy repartee, his guest gave a rambling formal speech, a page of which blew away. And yet most observers scored the encounter as a clear points victory for Mr Brown.

Neither the prime minister nor his young foreign secretary, David Miliband, who promenaded under the hot Camp David sun with Condoleezza Rice, his opposite number, has much experience of foreign affairs. But in his own idiosyncratic way, Mr Brown displayed an assured grasp of the feints, unspoken put-downs and subliminal messages of summitry. Invoking Churchill, he was warm about America and sounded resolute over Iraq and al-Qaeda: in an interview for American television, he said the fight with terrorism was “a struggle for the soul of the 21st century”—an ingratiating phrase, even if it was borrowed from Bill Clinton. In return, Mr Bush heaped praise on Mr Brown, not all of it double-edged: the prime minister, he said, was a principled, “glass half-full”, can-do kinda guy who “gets it”.

Mr Brown said precious little about Mr President, as he called his host, despite Mr Bush's efforts to relax into first names and his ice-breaking larks in Golf Cart One. Mr Brown described their talks as “full and frank”—old diplomatic code for “tense”—and semaphored a differing view of the world and its problems. He identified Afghanistan, rather than Iraq, as “the front line against terrorism”; Mr Bush was left to ventriloquise Mr Brown's alleged thoughts on the importance of success on the Tigris. Insisting that Britain would discharge its responsibilities in Basra, Mr Brown also made it clear that Britain would itself determine when those obligations had been met.

For the avoidance of doubt, and after a chat with Mr Clinton, Mr Brown made a speech at the United Nations in New York. The speech was mostly about global poverty, including the very Brownian idea of enlisting the private sector to help alleviate it. His visit coincided with the agreement of a new Security Council resolution on Darfur, which Britain had helped to craft. But it was an odd event, held in a small auditorium at the crack of dawn, and seemingly engineered as a way for Mr Brown to showcase his

commitment to multilateralism and “soft power”—in contrast to Mr Bush's unilateral militarism.

This sophisticated ambiguity is not an approach that is likely to survive first contact with an actual foreign-policy decision; but, on this occasion, it enabled Mr Brown to observe the niceties while distancing himself from both Mr Bush and his erstwhile swain Tony Blair. One lesson of the trip seemed to be that Mr Brown's diplomacy, like his domestic performance as prime minister so far, will combine high principle, low political calculation and an awkward demeanour—and that it may be more accomplished than many people expected.

Yet besides the much-remarked ties he relentlessly wore to signal seriousness, and the subtle rebuffs, Mr Brown's visit gave off other semiotic messages that told another, different story. America under Mr Bush is not at its most popular in Britain, or elsewhere. To many British eyes, both president and country are too bombastic, myopically self-assured, lacking a properly tragic view of life and sometimes emotionally incontinent: Mr Bush's allusion at Camp David to the death of Mr Brown's baby daughter—a tragedy, the president said, which had “strengthened [Mr Brown's] soul”—struck some listeners as unduly intrusive. But the British snootiness towards America is still combined, even more than in other countries, with a deep affection and even reverence that date at least from the second world war.

Still special

Beneath the circumlocutions, those feelings too were visible this week. The British journalists who travelled with Mr Brown, ostensibly eager to detect or imagine splits and gaffes, rubbernecked along the Mall in Washington on the misty morning of the meeting, effused over the Camp David cookies and revelled in the glitzy motorcade that conveyed the prime minister's party into Manhattan. Like a neglected lover instantly salved by an endearment, the Brits were pleased to hear even Mr Bush say that the alliance with Britain was indeed America's “most important bilateral relationship”. As for Mr Brown himself, Bernard Shaw's formulation—two countries divided by a common language—seems especially apposite when the people speaking it are a folksy Texan and a Presbyterian Scot. But with his tepid attitude to Europe and enthusiasm for market economics, Mr Brown is more American than he looks. Along with the ideological affinity, there was a palpable prime-ministerial thrill: Mr Brown had characteristically swotted up on Camp David's history in advance; afterwards, he was ebullient.

In fact, the dynamics of the “special relationship” have always modulated according to the sometimes diverging interests of the two countries—as, for example, in American ambivalence over the Falklands conflict—and the exigencies of domestic politics. At the moment, with Mr Bush's reliance on Britain as a last-ditch alibi in Iraq, the balance of power in the relationship has shifted in Mr Brown's favour, making him freer to cock the odd snook at Washington, as many Britons want him to, and perhaps also better placed to sway American policy. The urge to cock snooks, however, is itself a sort of deference.

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Correction: Flooding in Britain

Aug 2nd 2007
From The Economist print edition

Poor seamanship led us to claim in early copies of last week's paper that spring tides meant water levels in the Thames were low ("Double deluge", July 26th). The river was indeed low, but not because of spring tides. Apologies; the error does not appear in the online version.

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Non-violent protest

They shall overcome—but perhaps not always

Aug 2nd 2007
From The Economist print edition

AP

In many places, non-violent protest is the only kind that has any hope of succeeding. But it can still fail

IT SEEMS a very long way from the grimy neo-classical buildings of downtown Belgrade to the Maldives, an Indian Ocean archipelago best known as an attractive holiday destination.

But for campaigners against Maumoon Abdul Gayoom, who has ruled the 1,200 islets for nearly 30 years, the distance is not as great as it seems. Mr Gayoom's critics say they have taken heart from Serbia's October 2000 uprising, in which hundreds of thousands of people converged on the centre of the capital and forced Slobodan Milosevic to admit electoral defeat. “Comparisons can be drawn between Milosevic's Serbia and the current political situation in the Maldives.” That, at any rate, is the eager claim of an anti-Gayoom activist on an opposition website. He argues that in both cases, harsh, unaccountable rule led to miserable living standards.

The contrasts are also obvious: Milosevic was a globally infamous warmonger, whereas the politics of the islands are little known. Then take logistics: the Serbs who rose up against their leader could simply walk or drive to Belgrade; in the Maldives, many would-be rebels have to sail to their capital, Male.

For a growing community of activists and experts on the technique of non-violent action, the differences are secondary. The point, they say, is this: any authoritarian power can be shamed, discomfited, made to change course and ultimately overthrown if “people power” and shrewd tactics are combined. If this idea has had one big success, it is the “orange revolution” in Ukraine, where protests (see above) continue to be colourful.

In an electronic age, it is easy for opposition movements around the world to compare notes without help from others. But if protesters of many hues are meeting and cross-fertilising, that is in large part thanks to two groups based in Washington, DC, which help and publicise the work of non-violent campaigners.

One is Freedom House, best known for an annual index that classifies countries as “free”, “partly free” or “not free”. Its core concern is liberty—defined as elected, accountable government, the rule of law and human rights—rather than the means by which liberty advances. More narrowly focused on peaceful campaigns for change (including boycotts and strikes) is the International Centre on Non-Violent Conflict (ICNC), whose books, seminars, films and other products—including a game in which players test their wits against an imaginary tyrant—have provided tips for protest movements (and, presumably, for their oppressors) in many countries.

As their output is translated into more languages, the two institutions are in many ways at the peak of their influence. But in authoritarian countries—from Russia to Iran to Venezuela—whose leaders trade on xenophobia, protest movements with an American input (however indirect) are denounced as traitors; and their American advisers as ill-disguised agents for their country's government.

That is an over-simplification, putting it mildly. Freedom House began as a movement against Nazism; Eleanor Roosevelt was a co-founder. In the cold war, it was a foe of communism but also deplored the “non-freedom” of pro-Western regimes, from Chile to South Africa. Trustees have ranged from staunch Republicans to blue-collar Democrats like Lane Kirkland. ICNC is the creation of Peter Ackerman, an investment banker-cum-scholar who made a fortune in the 1980s' bond market and used it to indulge his intellectual passion: the dynamics of non-violent action.

The two institutions overlap: Mr Ackerman is now chairman of Freedom House; he became involved through his co-author (of a study showing that non-violent action was decisive in 50 out of 67 transitions to freer regimes), Adrian Karatnycky. Mr Karatnycky joined Freedom House in the early 1990s, later becoming president, after working for America's labour movement.

To understand why America's labour unions know something about non-violent protest, delve a bit further into political history. The transmitter of the flame was Bayard Rustin, a campaigner for African-American (and gay) rights who was adviser to Martin Luther King. Mr Rustin was an admirer of Mahatma Gandhi's campaign against British rule in India.

AP

In Papua, too, peace needs a chance

These days, Freedom House seems a little closer than ICNC to the establishment. George Bush chose the former institution as the venue for a big foreign-policy speech last year. That, combined with the president's use of Freedom House, and similar organisations, to channel some of his annual spending of $75m on “democracy” and “civil society” in Iran, has sent Tehran's rulers into a frenzy of suspicion. Indeed some Iran-watchers believe the president's efforts to promote change have helped the regime to quash even those reformers who have no foreign links. “It puts a target on the back of every dissident,” says Afshin Molavi, a writer on Iran.

Freedom House is no administration mouthpiece; it has irked conservatives by opining that civil liberties have been in better shape since Democrats took control of Congress. Still, its trustees say they are “united in the view that American leadership in international affairs is essential to the cause of human rights and freedom.”

As a spreader of news about non-violent campaigns of all kinds, ICNC spans an even broader ideological spectrum. “We are not interested in outcomes of left or right,” says ICNC's director, Jack DuVall. Nor will it offer specific advice to any of the movements with which it is in touch, ranging from Palestinian discontents to bitter exiles from Belarus. It just tells people which tactics have worked elsewhere.

One of the ICNC's strongest beliefs is that in places where a protest movement must choose between violence and non-violence, the latter works best. As cases where both ways have been tried, they cite opposition to Moroccan rule over Western Sahara, and the campaign against Indonesian rule over western Papua. Apart from the well-known “colour revolutions” against post-communist regimes, ICNC disseminates news about groups on the political left, like Brazil's Rural Workers' Movement (MST) which campaigns to take over “underused” land from big proprietors, citing the Brazilian constitution.

From Belgrade or Kiev to rural Brazil is a big leap. Leaders of the MST oppose “neo-liberal economics” and blame many of Brazil's woes on the global trading system. The Serbian uprising, and the “orange” and “rose” revolutions of Ukraine and Georgia brought those countries closer to the Western world, both politically and economically, and also to the global trading system. Some MST leaders prefer the autarkic ways of Venezuela and Cuba.

But at its purest, the doctrine of non-violence insists that the method is nearly as important as the message. It also claims that there is no regime or foe, however brutal, that cannot be weakened by non-violent means. Is that claim justified?

No tyrant lasts for ever, and the statement that any brute can be defied can't be disproved. But the experience of ex-Soviet republics suggests that mass protest by a courageous crowd won't always work. In two republics—Belarus and Azerbaijan—rallies have been dispersed and opposition neutralised. Brave souls like Alyaksandr Kazulin, a critic of the regime in Belarus, and Eynulla Fatullaev, an Azeri editor, languish in jail on phoney charges. And in both places, numbers, money and geopolitics have made a difference. The Azeri elite is riding high on surging oil prices; that makes it easier to buy off groups or individuals. In Belarus, there were protests over election fraud in March 2006 which resembled the mass protests that had prevailed in Ukraine 14 months earlier. But in Belarus (despite the solidarity offered by colour-revolution veterans from Georgia and Ukraine), the rallies attracted little over 10,000 at most. Those in Kiev had involved hundreds of thousands.

Regardless of the short-term outcome, non-violence theory is certainly relevant to many post-Soviet states. In most of them, even the mildest resort to force by protesters would be suicidal: it would give the authorities their excuse to portray their foes as “terrorists” against whom almost any measure could be justified. Russia is a case in point. Given that Vladimir Putin has shown no hesitation in violently dispersing, and tarring as traitors, small groups whose protests are fairly restrained, who knows what the president would do to people who fired so much as a popgun in anger?

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Football for the homeless

Who says it's only a game?

Aug 2nd 2007 | COPENHAGEN
From The Economist print edition

For people (or countries) who lose hope, football's magic can work

IF ANYTHING at all could delight, and briefly unite, the citizens of Iraq, it probably had to be a football match. And the nation's 1-0 victory over the Saudis on July 29th duly provided a moment of joy to a land mired in tragedy.

Are there any limits to the power of football's magic? In the Danish capital this week, there was an unusual contest whose aim was to provide a more durable answer to the travails of 500 players from 48 countries. And for anyone bored with doped-up cyclists and temperamental tennis players, the Homeless World Cup did seem different.

It took place on two small temporary pitches about the size of tennis courts in Copenhagen's main plaza. The participants were certainly quite a mixture: tall, small, chubby, thin, teenaged, middle-aged and of both sexes.

Whether they came from rich nations like Japan or America or poor ones like Kyrgyzstan and Burundi, they all had histories of homelessness and social exclusion. But despite their miserable past lives (alcoholism, drug abuse, poverty and neglect), the competitors never behaved like downtrodden victims. Their 15-minute contests were showcases of sporting grit and passion.

Is there any point to the show? What good can it do, sceptics ask, to parachute a slum kid into a glamorous world of air travel and swish hotels, just for a week?

Mel Young, a Scotsman who dreamt up the contest in 2001, says it amounts to far more than a few days of fun. “The critical thing is that when they go back they're changed people,” he says. A study of the 372 participants in last year's event in Cape Town showed that 73% had changed their lives for the better by coming off drugs or alcohol, moving into jobs, education, homes or training—or just rediscovering their families.

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Emissions trading

Lightly carbonated

Aug 2nd 2007
From The Economist print edition

Satoshi Kambayashi

European companies are not yet taking full advantage of carbon markets

IT SOMETIMES seems that plans for emissions trading are piling up even faster than the greenhouse gases they are designed to curb. In late July the first emissions exchanges in Australia and Canada opened, in anticipation of mandatory carbon-trading schemes in both countries. America already has a healthy voluntary carbon market, and will soon add an obligatory one for utilities in certain states. But the evidence from the most advanced such “cap-and-trade” programme, the European Union's Emissions Trading Scheme (ETS), suggests that companies are struggling to make the most of carbon markets.

In theory, cap-and-trade schemes allow firms to reduce their emissions at the lowest possible cost. Governments put a limit on the amount firms can pollute, and issue an equivalent number of allowances. Those companies that find they do not have enough must either cut emissions or buy spare allowances from others. But for the system to work efficiently, firms must take advantage of all opportunities to reduce the costs of participation.

Not all of them do, however. Last year, after the price of European allowances plunged, New Carbon Finance, a research firm, and Cantor CO2e, a brokerage, surveyed 452 participants in the ETS. The price had fallen because it had become obvious that governments had issued too many allowances and the market would soon be flooded. Yet 31% of respondents with allowances to spare said they would not sell them until the end of 2006, just in case a last-minute surge in their emissions left them short. Another 16% said they would wait until the end of this year, when the first phase of the ETS winds up. This caution has cost them dearly. The price of permits, which was roughly €15 ($19) at the time, is now less than €0.15 ($0.21).

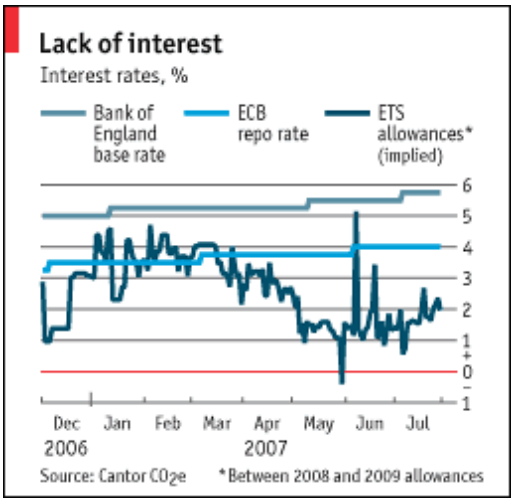
The root of the problem, says Guy Turner of New Carbon Finance, is that many companies view the ETS as a regulatory burden, rather than a chance to make money. They tend to put environmental experts, rather than financial whizzes, in charge of their participation in the scheme. The former, in turn, tend to concentrate on making sure that their firm has enough allowances, rather than on maximising their value. They are seldom used to trading, and are sometimes uncomfortable with the idea of “profiteering” from a system designed to cut pollution. Moreover, they have little incentive to stick their necks out by proposing elaborate transactions in the carbon markets, since they are unlikely to be rewarded if they succeed, but risk dismissal if something goes wrong. Governments do not help matters by handing out allowances to polluters for free, giving them little incentive to capitalise on what are actually valuable assets.

James Emanuel of Cantor CO2e points to several signs that firms are not exploiting carbon-trading

opportunities to the full. One example is the difference in price between European allowances and Certified Emission Reductions (CERs), which are carbon credits derived from emissions cuts in poor countries. Under the ETS, CERs are interchangeable with European allowances, within certain limits. Yet they are much cheaper. Firms holding European allowances could sell them now, buy CERs instead, and pocket the difference. The persistent difference in price suggests that few are doing so.

By the same token, on the futures market, there is hardly any difference between the price of European allowances to be delivered in 2008 and those to be delivered in 2009. Since firms receive their allowances from governments more than a year before they actually need them for compliance purposes, they could sell them and sign a futures contract agreeing to buy the permits they need a year later, at only marginally higher cost. This is tantamount to taking out a loan at an enticingly low interest rate (see chart).

But a growing number of firms, says Louis Redshaw of Barclays Capital, an investment bank, are now starting to take advantage of such opportunities. Emissions trading got off the ground earliest and has become most sophisticated, he points out, in the most economically liberal countries and in the most competitive industries. In Britain, for example, it got under way before the ETS was officially launched in 2005. In Poland, by contrast, it did not take off until last year.



Similarly, utilities in countries with liberalised energy markets were already used to trading power on a daily basis and to adjusting their power sources based on the changing costs of different fuels. Such firms already had plenty of experienced traders, and business models that could adapt to a variable emissions-price with relative ease. But utilities in regulated markets, let alone cement-makers, faced a far more daunting transition.

There are good reasons why some firms might be wary of emissions trading. For small firms the cost of analysing how to make money from their allowances could outweigh the benefits. Virtually all the 55 eligible paper mills in Britain opted to join a more rigid emissions-capping scheme instead of the ETS, simply to avoid the extra administrative burden, according to the Confederation of Paper Industries, a lobbying group. Other firms are so big that the profits to be made from permits, although substantial, would not be worth managers' time. Analysts say some big oil firms, for example, treat emissions trading as a distraction from their main business.

To complicate matters further, there are still some uncertainties about the legal regime for exchanging allowances and CERs across national borders. Lack of liquidity might account for some of the anomalies seen in carbon markets. And in a business driven by government regulation, there is always the risk that fickle politicians might change the rules of the game, with unpredictable consequences. On July 31st, for example, Latvia became the latest country to sue the European Commission for an increase in its allocation of allowances. If any of six such cases succeeds, it could contribute to another glut in allowances, and another slide in the price.

Nonetheless, a reluctance to trade allowances, whether driven by timidity or prudence, adds to the overall cost of emissions abatement. Despite misgivings about brokers keen to drum up clients for complicated transactions, Cameron Hepburn, an academic at Oxford University, agrees that most firms should pay more attention to emissions trading. “The faster they do,” he says, “the quicker we'll have an efficient carbon market.”

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Media

Rupert gets his trophy

Aug 2nd 2007 | NEW YORK
From The Economist print edition

Rupert Murdoch has won Dow Jones, demonstrating his dealmaking prowess

NEWS reports suggested that the result was in doubt right up to the end, but Rupert Murdoch's admirers were certain that he would prevail. “Rupert doesn't ask questions to which he doesn't already know the answer,” says one fellow media mogul. So when Mr Murdoch's News Corporation offered in April to buy Dow Jones, the owner of the *Wall Street Journal*, he was already pretty sure that the reply, which eventually came in the early hours of August 1st, would be yes—and it was.

Mr Murdoch has played a difficult hand brilliantly. He read the internal politics of the sprawling Bancroft clan, which owns a controlling stake in Dow Jones, perfectly—perhaps better than he reads his own family. His $5 billion offer was just high enough to swing the intergenerational politics of the Bancrofts his way, by enticing enough of the younger members of the clan to put money before the continuation of the family's long stewardship of the company. And when some members of the family tried to get Mr Murdoch to raise his offer, his refusal to do so and his threat to walk away were convincing enough to get them to agree to his original offer.

He also agreed to various measures to safeguard the *Wall Street Journal*'s editorial independence that were just sufficient to salve enough Bancroft consciences, without (judging by similar arrangements at the *Times* of London) meaningfully inhibiting his ability to do as he pleases.

The timing of the offer was equally astute, coming after the family had realised that the company faced huge strategic problems, but before the new chief executive they appointed last year had had time to show he could solve them, and so enable Dow Jones to prosper as an independent business. Arguably, Mr Murdoch's eventual triumph was guaranteed from the moment Dow Jones's board admitted that a merger might be the best strategy for the firm, and started to negotiate.

The biggest risk to Mr Murdoch was that another buyer, more acceptable to the family, would appear. But his generous offer scared off potential private-equity bidders. And although Dow Jones held talks with two possible bidders—Ron Burkle, a supermarket billionaire, and Brad Greenspan, an internet entrepreneur—it only seemed to be going through the motions.

Mr Murdoch's only real worry was that there might be a serious counterbid from the two firms with most to lose from his acquisition of Dow Jones: Pearson, which owns the *Financial Times* (and is part owner of *The Economist*), and General Electric (GE), which owns CNBC, a business-news channel. With Mr Murdoch's backing the *Wall Street Journal* will surely prove a much tougher rival to the *Financial Times*, and Dow Jones's resources might enable News Corporation's new business-TV channel, due to be launched in October, to do serious damage to CNBC. Yet despite rumours of a joint Pearson-GE bid, no such offer materialised.

Mr Murdoch has, however, paid a high price for Dow Jones—at least $1 billion, and perhaps $2 billion, more than appears justified by the fundamentals of the business—so News Corporation's shareholders may come to regard his victory as pyrrhic. No doubt Mr Murdoch's tougher management will squeeze out some cost savings. But his plans to generate strong growth, by expanding the *Wall Street Journal* and linking it with his other online and broadcast properties, do not seem terribly convincing. Which is why some News Corporation shareholders suspect that they are just excuses, and that Mr Murdoch has put his long-standing desire to own one of the world's great newspapers before any serious consideration of value for money.

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Deutsche Bahn

Summer of discontent

Aug 2nd 2007 | MAINZ-BISCHOFSHEIM
From The Economist print edition

Looming strikes and local politics dog a controversial privatisation

A STAND-OFF between two obstinate men close to retirement could determine the future of Deutsche Bahn (DB), Germany's state-owned railway company. Hartmut Mehdorn, DB's chief executive, is determined to keep finances tight ahead of a partial privatisation planned for next year; Manfred Schell, the head of GDL, the most militant of three railway unions, is hell-bent on getting his train drivers a pay rise of at least 31%.

Mr Mehdorn needs an infusion of cash from private investors to continue his expansion of DB as a logistics firm that carries international freight by road and rail, as well as passengers in trains and buses. As he seeks investors, Mr Mehdorn is in no mood to offer fat pay rises. But GDL's 12,000 members, representing a mere 5% of DB's workforce, are threatening to strike after August 6th if he does not give ground.

Railworkers at the vast goods yard of Mainz-Bischofsheim near Frankfurt, who themselves oppose a strike, say that a few drivers abandoning trains at strategic points could paralyse the system. On August 1st a court in Dusseldorf ruled such a strike illegal, but other courts have upheld the drivers' right to strike. DB has already agreed on a pay increase of 4.5%, the highest in Germany this year, with the two other unions. But that is not enough for Mr Schell, a 64-year-old radical who wants to end his career next year on a high note.

A strike might cost the German economy up to €500m ($685m) a day in missed deliveries, extra transport costs and lost workdays, estimates DIW, an economic-research institute. DB itself would forgo up to €42m in daily revenue if none of its 5m passengers or 1m tonnes of rail freight was able to travel, DIW says.

But worse for Mr Mehdorn would be the alienation of potential investors in his company. He recently had his contract extended to 2011, when he will be 68, purely to see the privatisation through. On July 24th the cabinet agreed to a privatisation bill which foresees the sale of a maximum of 49% of DB. The bill also grants DB use of the rail network for at least 15 years, though the tracks will remain in state ownership. Without this provision DB would have no chance of doing an initial public offering of a 25% stake next year, which is Mr Mehdorn's preferred privatisation route. (An alternative would be to sell a stake to a single big investor; RZD Russian Railways is reported to be interested.)

Yet obstacles remain. The sale still needs approval from the Bundesrat, the upper house which represents the regional Länder. Some regional finance ministers oppose it outright. Others dislike giving DB control of the rail network: the Länder are expected to pay part of a €2.5 billion annual network subsidy, but worry that local lines will be axed in the drive for profit.

Mr Mehdorn has fought to keep the rail network under his control, arguing that DB is best qualified to run a system that integrates trains with track. That is despite the openness of Germany's network to competition. Some 350 companies operate competing passenger services, mostly on short regional routes, with a market share of some 15%; a handful compete with DB's freight and long-distance passenger trains.

DB is supposed to manage rail traffic and invest in infrastructure on a “non discriminatory” basis, overseen by a regulator, the Bundesnetzagentur. But there are many ways in which DB can skew things in its favour. “As a commercial company, it is bound to,” says Claudia Kemfert of DIW. The delicate politics mean that Mr Mehdorn wants to avoid a damaging strike. No wonder Mr Schell sees this as a good time to demand more pay for his drivers.

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Business in China

Dirty dealing

Aug 2nd 2007
From The Economist print edition

Despite a clampdown, corruption remains a formidable problem

Get article background

THE announcement on July 26th that Chen Liangyu is to be prosecuted for corruption came as little surprise. The former chief of the Communist Party in Shanghai had been the subject of a well-publicised investigation since a 3 billion yuan ($390m) hole was found in the city's pension fund last year. Mr Chen's is the highest-profile corruption case for a decade, and although his prosecution is suspected of having political motivations too, it is a signal that the government is serious about clamping down on corruption.

This week several top media officials in Guangzhou were arrested for allegedly selling advertising slots privately. The stockmarket has also suffered from a rash of dodgy dealing, with 11 firms blacklisted and almost 300 people penalised in the past six months for activities including publishing fake company reports and false auditing. Every week, it seems, the local press has stories about people who have illicitly squirrelled away huge sums.

The fact that these crimes are now reported is itself a step forward. As in many countries the mentality of graft is deeply ingrained in China. But Chinese graft has particular characteristics: the dishonesty often takes place at very senior levels and frequently involves groups rather than individuals. There were more than 20 people involved in Shanghai's pensions scandal, and ten in this week's media case.

Within businesses, the most likely areas for graft are the purchasing or finance departments, where staff are given kickbacks from suppliers, or the personnel department, where employees are bribed to arrange interviews or jobs. The problem has become so bad that many foreign executives claim to be “overwhelmed by the business of kickbacks,” says Stephan Rothlin of the Centre for International Business Ethics (CIBE) in Beijing.

But he says it is a mistake simply to translate or impose Western ethical standards. Although much of the corruption is driven by greed, it is also the result of a different set of beliefs. Confucianism puts loyalty to family and friends first. Then comes “face”, and finally compliance with the law. Even then, the law is seen as malleable rather than absolute. Mr Rothlin argues that foreign firms need to strike a balance between imposing their own ethical codes and understanding the local culture.

It is even harder to deal with lower-level shadiness, such as a secretary booking a flight for her boss and then getting a payment from the travel agent, or a receptionist getting paid to refer new enquiries to a rival firm. Such cases usually involve relatively small sums and are often regarded as a socially acceptable way for employees to prepare for retirement or keep up with the spending of their peers.

Dane Chamorro, the regional manager for China at Control Risks, a consultancy, says the law against commercial corruption is rarely enforced—and when it is, prosecutions usually have additional motives. He suggests that foreign firms start their operations from scratch and impose their ethical standards from day one. They also need to avoid hiring “tribes”—groups of workers from the same region, or who speak the same dialect. Such groups are known to move systematically between businesses, especially foreign ones. Training is important too, as are regular audits.

But even though there is a growing push for a clampdown, the resistance to change is strong. *Fu ze ren bu zai*, “the man with the key is not here”, is a common way of asking for a bribe. Alas, the man with the key to solving China's corruption problem is nowhere to be found, either.

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Marketing to Muslims

Food, fashion and faith

Aug 2nd 2007
From The Economist print edition

Companies are starting to reach out to Muslim consumers in the West

MARKETERS and self-proclaimed trendspotters in the Western world love slicing and segmenting consumers into an ever larger number of categories. They created the teenager, the yuppie, the baby boomer, the singleton and the metrosexual. For all of them they invented “needs” that could, inevitably, be met by whatever product they happened to be promoting. Yet to this day they tend to tiptoe around Muslims as a distinct market segment. Although they have settled into a fairly comfortable relationship with Jews and Christians whose cultures they feel they know and understand, the cultural divide with the Muslim world seems to be too daunting.

But a new study by JWT, an advertising agency, points out that the 6m or so Muslims in America are, on average, richer and better educated than the general population. Two-thirds of Muslim households make more than $50,000 a year and a quarter earn over $100,000; the national average is $42,000. Two-thirds of American Muslims have a college degree, compared with less than half of the general population. Muslim families also tend to have more children. So the perception that marketing specifically to Muslims is not worthwhile would appear to be wrong.

According to JWT food, finance and packaged goods are the three consumer markets most affected by Islamic law. The global *halal* market is worth some $580 billion annually. In America an estimated 16% of sales in the $100 billion kosher industry comes from Muslims who lack adequate *halal* options. Manischewitz, the leading maker of kosher foods, has already spotted an opportunity. Last year it launched its first campaign under the theme “Simply Manischewitz” designed to reach out beyond Jewish customers.

Muslim-owned consumer-goods companies are also beginning to tap the Muslim market in the West. Since January the Burqini—a full-coverage swimsuit made by Ahiida, whose founder is a Lebanese immigrant in Australia—has been sold internationally, mainly online. As the name implies, the polyester suits are a cross between a burqa and a bikini, and are designed in accordance with Islamic law requiring women to dress modestly.

Similarly NewBoy Toys, a Syrian firm, has created Fulla as an alternative to the blonde, big-breasted Barbie doll made by Mattel, an American toymaker. Fulla has dark hair, brown eyes and a small chest, and wears a white headscarf and a coat. Unlike Barbie, Fulla does not have a boyfriend or a job, say her makers. She spends her time cooking, reading and praying.

Big Western companies have also started to reach out to Muslim consumers, albeit slowly. In April McDonald's, the biggest American chain of fast-food restaurants, began serving *halal* Chicken McNuggets and other food items permissible under Islamic law for a trial period at a restaurant in Southall, in west London. The firm is treading carefully: the new offerings are not advertised beyond the walls of the restaurant. Yet demand is strong, sales are increasing, and McDonald's is thinking about extending the experiment.

Such companies are also trying to be more sensitive and inclusive in their approach to Muslims. Each year Coca-Cola, the biggest maker of soft drinks, runs a series of marketing initiatives focused on charity and tolerance during the Muslim holy month of Ramadan. An ad based on the concept of sharing food during *iftar*, the fast-breaking meal after sunset, is especially popular. Yet Coke is not adapting its global brands to Muslim consumers. “We don't segment our consumers based on religion,” says a spokesman for the firm.

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Cross-border shopping

You'd be a loonie not to

Aug 2nd 2007 | NORTH CONWAY, NEW HAMPSHIRE, AND TORONTO
From The Economist print edition

The strong Canadian dollar means bargain prices south of the border

Get article background

VISIT the Ralph Lauren outlet in North Conway, New Hampshire, this summer and you may hear as much French being spoken as English. With the Canadian dollar hovering close to parity with the American dollar for the first time in 30 years—it touched $0.96 in the last week of July—Canadians are rushing to the United States to shop. Buy $180 in clothes and it costs just C$191, plus C$11 in federal sales tax paid at the border. In 2002, when the Canadian dollar was trading around $0.64, the same bag of clothes would have cost C$281.

The loonie—a nickname derived from the northern bird depicted on the one-dollar coin—has appreciated in value against the greenback by more than 10% since January. This is due to a combination of the American dollar's weakness, higher interest rates in Canada, and the high prices of Canadian exports such as oil, nickel, copper and zinc.

It is not only preppy clothes that are drawing Canadians south. In the first half of this year Canadians imported 64,096 vehicles from America, up 29% from the same period in 2006. In May, when the Canadian dollar was trading at $0.92, a lawyer in Toronto who wanted a top-end Mercedes S63 AMG was quoted a price of C$171,000 by Mercedes Canada. He threatened to cross the border and buy it for $127,000, so Mercedes dropped the price to C$149,500.

Similarly, a Porsche Cayenne Turbo costs $98,000 in the United States but C$125,000 ($118,000) in Canada. Some dealers say sales have declined by a quarter thanks to cross-border shopping. They are begging carmakers to cut their list prices, but so far most have not.

In once-booming shopping towns on the Canadian side, meanwhile, shops are closing. Knowlton, in southern Quebec, a 20-minute drive from the border with Vermont, used to attract droves of American shoppers when the Canadian dollar was worth $0.66. Now many shops sit vacant. In Bromont, a nearby ski town, rows of shops are being converted into expensive apartments.

The provincial government in Quebec is running advertisements asking people to shop at home. But New Hampshire has no sales tax, whereas Quebec's is 14%. Quebeckers, the biggest wine drinkers in Canada, are also driving south to buy wine. Michael Serra, a wine dealer in Plattsburgh, New York, an hour south of Montreal, says sales to Canadians are up 30% from last year. The biggest sellers are the wine-boxes that he sells for $16—half the price in Canada.

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Face value

The nimble sumo

Aug 2nd 2007
From The Economist print edition

Eyevine

Jean-Pierre Garnier of GlaxoSmithKline defends the pharmaceutical industry as he overhauls his own drugs firm

THIS would seem to be a terrible time to be the boss of a big pharmaceutical company. Customers and regulators are fretting about safety after the high-profile recall of Merck's Vioxx, a painkiller that turned out to be dangerous for some patients. The number of new drugs gaining approval has plunged in recent years, casting doubt on the industry's research model. Poor countries are making noisy demands for free drugs and are threatening to override patents through “compulsory licensing”. All this has battered the shares of the drugs giants and forced out the chief executives of three of the biggest in the past two years. And yet here is Jean-Pierre Garnier, the boss of GlaxoSmithKline (GSK), beaming confidently as he defends his industry. “My generation of chief executives is the first that ‘gets it’,” he declares.

What explains the ebullience displayed by J.P., as he is universally known? One reason is his successful defence of Avandia, a blockbuster diabetes drug that had threatened to go the way of Vioxx. A safety scandal blew up in May when a leading cardiologist published a statistical study suggesting that Avandia might increase the risk of cardiovascular problems. Sales, which topped $3.3 billion last year, plunged by a fifth in the quarter ending in June. In the wake of the Vioxx scandal many drug companies have been eager to avoid messy confrontations over safety. But not Mr Garnier. He came out swinging, accusing critics of politicising the regulation of drugs and rebutting the study's claims with his firm's own data. This week an expert panel convened by America's Food and Drug Administration (FDA) voted overwhelmingly to keep Avandia on the market, albeit with stronger warnings about potential side-effects. As one analyst put it, GSK “dodged the FDA bullet”.

Another reason Mr Garnier is smiling is that GSK has the strongest drugs pipeline of any big firm. It has 33 drugs in the late stage of clinical trials, with perhaps two dozen due to be launched between now and the end of 2009. That is much better than at rival firms, and far better than the pitiful prospects Mr Garnier inherited when he took over as boss of SmithKline Beecham in 2000, just before the merger with Glaxo Wellcome. The industry's poor research output has led some critics to argue that the huge mergers of the past decade have produced giant firms that are too big and bloated to innovate. Mr Garnier disagrees. “R&D productivity is not linked to size,” he insists. He invokes the image of a successful sumo wrestler and says giants can be nimble if they are clever. Indeed, size can be an advantage in marketing, or when organising massive clinical trials, he observes.

But he accepts that size is a problem early in the drug-development process. “Drug finders” and innovators may well get tripped up by bureaucracy and tangled in red tape; good ideas are lost. Even worse, bad ideas may not be weeded out in time: Pfizer, for example, spent $1 billion to get Torcetrapib, a cholesterol drug, to late-stage testing only to discover dangerous side-effects that forced it to abandon

the potential blockbuster.

So Mr Garnier has tried hard to decentralise. He did away with GSK's top-down approach to research, replacing it with a number of autonomous research clusters known as “centres of excellence in drug discovery”. The idea is that these smaller groups will take many more “shots on goal” than bureaucratic research monoliths like Pfizer. Crucially, he wants them to fail more quickly too, thus sparing the firm the huge expense of a late-stage withdrawal. Surprisingly for an industry veteran, Mr Garnier has also taken on the tradition of secrecy by experimenting with “open innovation” models. Managers are now rewarded for successful inventions whether they were developed in-house or acquired from outside. He reckons this eliminates the “not invented here” syndrome common at big drugs firms.

Self-confidence or arrogance?

A driving force behind Mr Garnier's success is a brash self-confidence that even one of his lieutenants considers “arrogant”. The American-educated Frenchman, who lives with his family in Philadelphia, has ended up in hot water a few times as a result. In 2003 he was branded a “fat cat” by the press for trying to push through a £22m ($36m) pay-and-benefits package. In a move rarely seen at a British firm, shareholders voted against the resolution. Mr Garnier now seems to have a healthy respect for shareholders, even initiating a recent share-buyback to appease their concerns about a weak share price. His instinctive cockiness also got him into trouble with developing countries. Soon after taking over as boss of GSK he found himself ensnared in a controversy over access to cheap HIV drugs, a row portrayed in the media as drugs giants cruelly ignoring the plight of dying Africans. Mr Garnier's first instinct was to fight. But although he was confident of his firm's legal position, he was losing the media war. So he chose to cut his losses and made a dramatic U-turn. “For the very poor countries of this world,” he explains, “we decided to sell our drugs completely not-for-profit.”

GSK's attitudes toward the poor are now regarded as a model for others. The firm encourages generics-makers to produce its formulations, so costs can fall further. It offers tiered pricing, linking the price of drugs to a country's ability to pay and offering subsidies for the poorest. Even the World Health Organisation, a United Nations agency not known for cosiness with the pharmaceutical industry, applauded GSK's decision in June to donate 50m doses of its new flu vaccine to be held in an emergency stockpile. This transformation, of both GSK and of its boss, suggests there is hope yet for the pharmaceutical industry. “Society puts up with Big Pharma only because we come up with innovative drugs,” says Mr Garnier. The world desperately needs a self-confident drugs industry willing to take risks to discover new therapies, but will no longer tolerate its arrogance and neglect of the poor.

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The credit squeeze

Abandon ship

Aug 2nd 2007
From The Economist print edition

Andy Potts

Investors sail into a credit storm amid worries about the debt markets

Get article background

THE symbolism is almost too perfect. According to TheStreet.com, a financial website, John Devaney, a hedge-fund manager, has put his 142-foot yacht *Positive Carry* up for sale, along with his 16-bedroom mansion in Aspen, Colorado. Funds run by Mr Devaney's group, United Capital, have had to halt payouts to investors after making heavy losses on mortgage-backed bonds.

Ironically, Mr Devaney's early life pointed to the excesses that were to come. He used his student credit card to buy a house, on which he took out a second mortgage. But Mr Devaney's recklessness was not unusual in the recent global debt bonanza, where rash lending became commonplace. Bank executives will be haunted by memories of Ninja loans (to people with No Income, No Job or Assets) and Pik toggles (agreements that gave firms the right to pay interest in the form of further IOUs rather than cold, hard cash).

Hedge-fund managers, such as Mr Devaney, were happy to borrow money to buy those loans because they made the “positive carry” that he boasted about; ie, the return on their holdings was greater than the cost of financing them. What they forgot was that relying on positive carry alone comes with a risk: that the debtor will not repay the loan.

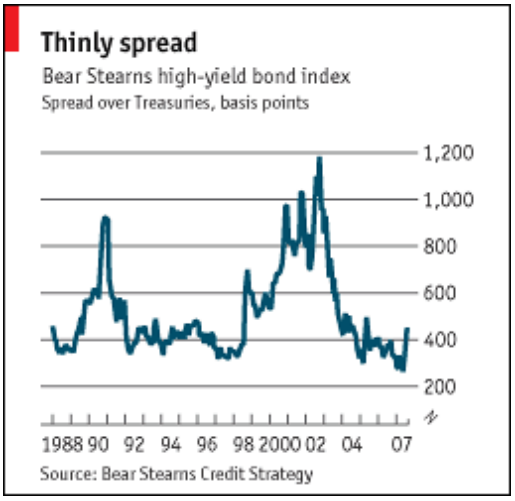
Now, at last, investors and lenders have woken up. Credit spreads, the premium that riskier borrowers must pay over government debt, have surged since June. That is a problem for companies and banks in the middle of doing deals. Financing packages for the takeovers of Alliance Boots, a British health-care chain, and Chrysler, America's third-biggest car giant, have been postponed. Merrill Lynch says some 35 bond or loan deals have been cancelled or restructured in the past five weeks. And it is not just the riskiest borrowers that have been affected. Globally, only $98 billion of investment-grade bonds (to the most creditworthy borrowers) were issued in July, the lowest since August 2004.

The stockmarket has reacted with alarm to this credit squeeze, partly because it was counting on a continuous stream of debt-financed takeovers to push share prices higher. That confidence has now gone, and with it the market's swagger.

The change in mood was swift. On July 19th, the Dow Jones industrial average closed above 14,000 for the first time. By July 27th investors were as risk averse as at any time since September 2001, according to UBS's risk index. But for all the nervousness, there has not (yet) been a calamitous decline in share prices. In percentage terms, the 311-point fall in the Dow Jones Industrial Average on July 26th was only

the 698th largest in history. The Dow has yet to fall 10%, the level that qualifies as a correction in market lore.

As for credit markets, the remarkable thing is the low level of spreads before the sell-off, rather than where they are now (see chart). Spreads would have to double to get back to the levels of the early 1990s and almost triple to be where they were after Enron and WorldCom collapsed in 2002. And thanks to lower yields on government bonds (as investors sought out safer assets), the price of debt for companies with a Baa rating from Moody's is little changed from mid-July, according to the Federal Reserve.



Many companies have no need to borrow. Corporate profits are still rising, although at a slower pace than in recent years. Jan Hatzius of Goldman Sachs points out that American companies overall have enough cashflow to cover their capital expenditure.

Nor are firms having problems paying back their existing debts. According to Jim Reid of Deutsche Bank, the global default rate is 1.38%, near the bottom of its historical range. Standard & Poor's, a ratings agency, had 621 bonds on standby for a downgrade in mid-July; that was slightly below the 12-month average.

As a result, the latest bout of investor caution might have only modest repercussions for business investment. It might even do some good. Richard Berner, an economist at Morgan Stanley, suggests that as the terms of acquisition finance become unfavourable, companies might think less about buy-outs and switch their energies to growing businesses through capital spending. If so, greater caution in the financing of leveraged buyouts (LBOs) could even boost the economy.

Yet the dire situation in America's housing market cautions against a too sanguine view of the latest credit events. There, the deadly combination of loose lending practices and higher interest rates has created a prolonged, and ever-deepening, bust.

Residential construction has plunged and house prices have fallen. Mortgage defaults have soared, particularly among the least credit-worthy subprime borrowers. Home-owners who took out mortgages at cheap introductory rates face sharply higher payments as these loans reset. There have been plenty of financial-market casualties. The latest was American Home Mortgage Investment, a largish lender which this week said it would no longer fund home loans.

And there is almost certainly worse to come. With demand weak and the stock of homes for sale close to its highest level for 15 years, prices are likely to fall further. Tighter lending standards will reduce the supply of new homebuyers, putting further downward pressure on prices. This squeeze (along with higher petrol prices) has already dampened consumer spending—and is likely to continue doing so.

Small wonder that financial markets have decided that monetary policy may soon be loosened. Few expect the Federal Reserve to cut short-term interest rates, which are currently at 5.25%, at its next meeting on August 7th. But judging by the prices of federal funds futures, a rate cut this year—barely considered a possibility at the beginning of July—is now priced in as a virtual certainty.

In fact, markets may be too optimistic about the odds of a cut. Americans' domestic spending may be weak, but the strength of the global economy has boosted exports. With unemployment low and oil prices high, the central bankers are still worried about inflation. Provided it does not unduly disrupt financial markets, the Fed probably welcomes the repricing of credit risk.

That is a big change from 1998, when the fallout from the Asian financial crisis and Russia's debt default reached a critical level, prompting the central bankers to cut rates quickly. At that time, much of the developing world was in recession and the American economy was the mainstay of global growth. The Fed could rely on the deflationary impulse from abroad to contain price pressures. Today the world economy is growing strongly, despite the weakness in America.

This point was underlined by the IMF's most recent forecasts, released on July 27th. The Fund cut its projections for America's GDP growth this year from 2.2% to 2%, but raised its forecast for global growth from 4.9% to 5.2%. Even if financial markets are in thrall to events in America, the world is less dependent on its economy.

The moderation

For all that, financial markets could still create even nastier economic problems. That is mainly because of the large, and ill-understood, debt piles they have generated. Ironically, the greater stability of the world economy may be to blame. The absence of severe recessions or abrupt shifts in monetary policy has made investors more confident, and thus more willing to borrow. Greater confidence has driven down yields as investors needed less compensation for risk. As a result, hedge funds that promise high returns (especially after deducting their substantial fees) need to take outsized bets to deliver.

Ever-innovative financiers have given hedge funds new tools to double up their bets. Credit derivatives have made it easier to separate the credit risk (the danger of default) of bonds from the interest rate risk. They have also allowed investors to make big bets, despite putting little money down. And they have widened the range of investors who can get involved in risky asset classes, such as subprime mortgages and junk bonds.

Traditionally, many stodgy investors, such as pension funds, steered clear of such things because they lacked an investment-grade rating. But banks can now bundle together risky assets into collateralised-debt obligations or CDOs. The CDOs slice and dice these debts to suit potential investors. The riskiest tranche, known as equity, earns the highest return but takes the first hit from any defaults in the underlying portfolio. By adding other tranches on top, each taking progressively less risk, it is possible to create a security that the rating agencies place in the coveted triple A class from a pile of junk bonds.

Fine in theory, but only now are these new instruments being tested. And some are flunking. Defaults in the 2006 vintage of subprime loans have been much higher than expected. The riskiest mortgage-backed securities trade at around 40 cents on the dollar. This has rippled through to the CDO market, prompting the near-wipeout of two Bear Stearns hedge funds.

The problems at Bear Stearns triggered the current market decline. Investors were surprised by the scale of the losses and the time it took for them to emerge. And attempts by Merrill Lynch, one of the prime brokers to the Bear Stearns funds, to sell some of their assets showed how illiquid the market for such securities had become. The security in credit derivatives, it seems, is not so certain after all

Then there are the banks themselves. In theory, the derivatives markets have strengthened the financial system, by allowing risk to be dispersed away from the banks. But banks still have two vulnerable points. The first is the period between their agreement to launch a deal and its subsequent sale to investors. The fees for arranging deals, particularly the LBOs beloved by private-equity firms, are highly attractive. So banks have used their capital to underwrite such deals (see article). Suddenly, they have found they do bear the risk after all.

Then there is the link to hedge funds. Ever since the demise of Long-Term Capital Management in 1998, regulators have worried that banks might lend too much to individual funds. But the Bear Stearns debacle shows that banks may also have to stump up capital to rescue hedge funds within their own stable. Bear had to promise an additional $1.6 billion of collateral to the funds' prime brokers.

All this puts banks in a dilemma. Prime brokers, the arm of investment banks that deals directly with the hedge-fund sector, are imposing tougher lending terms to protect themselves against the risk of collapse. But the bond-syndication arms of those same banks need hedge funds to buy the debt they issue on behalf of their corporate clients. Tighter lending standards may, in effect, be cutting off their noses to spite their faces.

At the moment, most banks' balance sheets look pretty secure. The latest figures from the *Banker* magazine show that among the world's top 1,000 banks, Tier 1 capital—the most reliable liquid sort—rose by 18.3% last year. And Kevin Gardiner, of HSBC, says that profits forecasts for banks are still being revised higher.

But things could easily get nastier. And it is already clear that the titans of Wall Street and London will face a tricky summer. Holidays in the Hamptons and Tuscany will be cancelled. And more yachts will be put up for sale.

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The effect on financial firms

Holiday horrors

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There are losers, but some winners too

Get article background

“I KEEP thinking how nice it would be to turn off my computer and not come back until September,” says the head of leveraged-lending at a large bank. As the spasms in the credit markets claim more casualties, and unsold bonds and loans for funding leveraged buyouts pile up, wails of pain are echoing across Wall Street and beyond. But they are interrupted by the occasional hoot of pleasure.

Start with the victims. For private-equity firms new deals are suddenly harder to do and existing ones costlier to refinance. Their mega-funds may struggle to deploy their estimated $300 billion-500 billion of financial muscle. This could scupper Kohlberg Kravis Roberts's hopes of following Blackstone to the stockmarket. KKR looks particularly vulnerable because it is less diversified than its arch-rival in the leveraged-buyout business.

As credit for buyouts dries up, the biggest losers are the banks left holding “hung bridges”. These are loans to buyers that were supposed to be temporary and for which the banks charged fees. As the price of the loans falls in the secondary market—to below 85% of their value in some cases—a number of banks could face big losses. To add to their woes, private-equity clients are also more likely to tap undrawn loan facilities which were negotiated some time ago on more favourable terms.

Some of these risks can be hedged in the derivatives markets. But with a backlog of more than $300 billion, banks may end up selling loans at a discount to make room on their books for new commitments. According to the head of a hedge fund that does a lot of business with large banks, their lending desks are now being stripped of risk-management responsibilities by livid chief executives.

One boss who is probably more embarrassed than angry is Citigroup's Chuck Prince. His recent comment that the bank was “still dancing” in the loan markets has quickly returned to haunt him. Citi is the most exposed of all banks, having “tried to buy the market at the worst of times”, as one competitor puts it. It was the lead arranger on $25 billion of the roughly $40 billion of bonds and loans withdrawn in recent weeks. Things may get worse: Citi is involved in financing some giant buyouts still to come to the market, such as TXU, a Texas energy-utility, and First Data, which processes credit cards.

Citi should be able to take the losses in its stride, given its enormous balance sheet and low cost of funds (thanks to cheap deposit funding). But most investment banks do not have the luxury of also being a big universal bank. No longer happy to act mainly as middlemen, many have wanted a slice of the action themselves. Wall Street's five big investment banks—Goldman Sachs, Morgan Stanley, Merrill Lynch, Lehman Brothers and Bear Stearns—have piled into potentially illiquid (and thus risky) assets, from bridge loans to collateralised-debt obligations (pools of tranched debt), over the past three years. Their lending commitments rose from around $50 billion in 2002 to over $180 billion in 2006, according to Moody's, a credit-rating agency. In Merrill Lynch's case, these commitments far exceed the bank's capital base—although they also include safe loans to blue-chip companies.

Buying shares of an investment bank today is “more of a religious experience—one based on faith—than an investment”, says Dick Bove, of Punk Ziegel, an investment bank. Bear Stearns's shareholders have had their faith severely tested. Two of the bank's hedge funds have imploded and a third has stopped investors from withdrawing funds. Even more vulnerable are stand-alone hedge funds that borrow heavily to dabble in debt. As easy financing evaporates, investors want their money back and the prime-brokerage units of banks that lend to them want more collateral, or “margin”. Credit funds were up by a mere 0.2% in June, according to Credit Suisse. Returns in July are expected to be negative.

Highly leveraged funds sink quickly in such choppy markets. Witness the demise of Sowood Capital, a $3 billion fund that lost half its value in short order and this week sold its credit holdings at a discount to

Citadel, another hedge fund. Sowood was caught out in two ways: it over-borrowed and its hedges failed to neutralise its risks as expected. The debacle suggests that even the canniest of investors can slip up: the managers of Harvard's successful endowment have lost $350m investing in Sowood, according to reports.

The intervention of Citadel—which last year snapped up bits of Amaranth, another troubled hedge fund—is seen by some as encouraging. It suggests that large, diversified funds will not only survive, but could prosper by swooping on assets they consider cheap. The top 20 or so funds, including Citadel, have the reputation (and pay big enough fees) to negotiate hard for more flexible financing arrangements. So they are less likely to get caught out.

Short on the problem

Smaller funds can prosper too. Paulson & Co, a fund based in New York, has done well from betting early that securities backed by subprime mortgages would fall in value. The good times may continue for other funds that are “short” on subprime.

But there are signs that the pain is spreading to other countries. Several European banks and insurers are rumoured to be sitting on “mortgage bombs”—troubled assets linked to America's subprime mess. IKB Deutsche Industriebank, which lends money to Germany's middle-sized companies, is being bailed out by a group of banks including the state-owned bank that partly owns it, thanks to ill-judged punts on American mortgages. And Australia's Macquarie Bank, which has been growing rapidly and buying up big infrastructure projects, has said two of its funds may post losses because of subprime woes.

One German bank, however, is doing well out of the subprime mess. After one of its analysts predicted two years ago that a slump was coming, Deutsche Bank piled into derivatives contracts that gain in value as the housing market sinks. These bets are thought to have netted the bank at least $250m, perhaps much more.

But it is traders of distressed corporate debt who are wearing the broadest smiles. After four years of infuriatingly strong markets, they finally have wads of discounted bonds and loans to feed on. Goldman Sachs, for one, has upped the size of a junk debt-fund it is raising, from $12.5 billion to $20 billion.

Though the mood has clearly darkened, no one really knows if this is the crunch that the markets have been anticipating. As Stephen Green, boss of HSBC, a global bank with copious subprime troubles, put it this week: “It is too early to tell if this is a temporary bout of indigestion or whether a whole new pricing structure will have established itself when people get back from their holidays.” Turn off the computer, head to the beach, and hope.

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Tax reform

Overhauling the old jalopy

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Satoshi Kambayashi

Tax competition is starting to hurt America. But can Uncle Sam muster the political will to fight back against his tax-cutting foreign rivals?

Get article background

IT IS more than two decades since America led the world in tax reform, and what Ronald Reagan called "that old jalopy of our tax system" is looking in need of a lot more than a new spray of paint. Last week Hank Paulson, the treasury secretary, held a summit in Washington, DC, to address the part of the system that is most visibly lagging behind best practice in the rest of the world—the taxation of firms.

The gathering of tax experts, business leaders and other heavy-hitters, including Alan Greenspan, former chairman of the Federal Reserve, agreed with Mr Paulson that Uncle Sam was "undermining the competitiveness of American workers" with high corporate tax rates. However, nobody at the summit expected Congress to do much about it, especially given its current preoccupation with easing taxes on the middle class and increasing them on the rich, particularly those who have made their fortunes in private equity.

America's competitiveness problem has been a constant theme of Mr Paulson's time at the Treasury, which he joined a year ago after running Goldman Sachs. As well as taxes, he is worried that America's capital markets are struggling to hold their own against resurgent financial centres such as London and Hong Kong.

Corporate-tax reform was a key part of the Reagan blitz, too. Following the Tax Reform Act of 1986, the base of the corporate income tax was broadened but the top rate was slashed by 12 percentage points, from 46% to 34%, the biggest cut since the tax was introduced in 1909. Thus began a trend of reducing the tax rate on companies that has spread across the globe. However, whilst countries from Ireland (with a rate of 13%) to China—which recently passed a law cutting the rate to 25%—have continued to lower corporate taxes, American rates have edged back up, to 35%, in 1993. Adding state taxes to federal ones gives an overall rate of 39%. That is the second highest in the OECD, in which the average rate is 31% (see chart).

In a world of multinational firms and mobile capital, tax rates can make a significant difference to where profits are recorded and business is done, though economists disagree on how much. Governments

outside America have long worried that competition between countries to attract international businesses creates pressure to lower corporate tax rates. America is now belatedly starting to agree with them.

If headline tax rates were all that mattered, America would be an unattractive place for companies to locate. In fact, tax is not the only thing firms take into account when deciding where to locate. And companies care less about the official tax rate than what they actually pay after taking into account the various allowances and breaks that countries offer. Ranked by this “effective marginal tax rate”, America lags behind by less, though its rate of 24% is well above the OECD average of 20%.

The big gap between the headline and effective marginal tax rates reflects the large number of allowances given to firms for doing particular activities, such as research and development. Many of these allowances are fiendishly complicated; they distort business decisions and raise the cost of tax compliance.

The Treasury is also worried about another big distortion caused by the corporate tax system—the incentive it gives to use debt rather than equity finance. Equity capital is subject to double taxation. It is taxed first when the company declares a profit, and again when it is paid to shareholders as dividends or capital gains. Money paid out by the firm as interest is taxed only once, as income to the investors who receive the interest.

Companies can avoid this double taxation either by setting themselves up as partnerships, or by becoming an “S corporation”, a unique creation of America's tax code which gives a business limited liability without incorporating. An S corporation's profits are taxed just once, as the income of its shareholders. The number of these entities has soared in recent years, and they now account for about half of the income earned by American businesses.

This is business voting with its feet on a grand scale—but many of America's largest and most internationally mobile firms are unable to become S corporations, which have tight rules, not least being limited to a handful of shareholders. Congress is considering a law that will require private-equity firms that go public to start paying corporate tax—thanks to the furore over Blackstone's initial public offering in June, which the private-equity giant structured to avoid corporate tax. This law could perhaps be justified on grounds of equal treatment: the private-equity firms would be on a more even footing with other listed companies. But it would extend the scope of double taxation.

Congress is also considering taxing the carried interest of partners in private-equity firms as income rather than capital gains, which are taxed at a lower rate. The idea has merits—carried interest does indeed look more like income than equity. But Glenn Hubbard, dean of Columbia Business School and a former chairman of George Bush's Council of Economic Advisers, notes that private-equity partners, given the sort of accountants that they can afford, would no doubt find a way to avoid the higher tax.

Mr Hubbard thinks that America should now cut the corporate tax rate. Such a cut could be partly paid for by removing some of today's allowances. The Treasury calculates that getting rid of all existing allowances would broaden the tax base enough to allow the rate to be cut to 27%—though Mr Hubbard is sceptical that such a wholesale reform would be politically feasible, as some allowances, such as the research tax credit, are too popular with business. Instead, he wants America to raise money elsewhere, perhaps through consumption taxes as in Europe.

How much should the corporate tax rate be cut? Alan Auerbach of the University of California, Berkeley, says it would make sense for America to move more in line with other countries. Unfortunately, in the current political climate, even that idea seems outlandish. But Mr Hubbard, for one, thinks things would be different if voters realised who actually pays the tax. The evidence, he says, suggests that the burden of the corporate tax falls disproportionately on workers. For instance, a study by Kevin Hassett and Aparna Mathur of the American Enterprise Institute, looking at 72 countries over 22 years, suggests that a 1% increase in corporate tax rates results in a 0.8% reduction in manufacturing wage rates. Other studies paint a similar picture. If workers understood that corporate taxes are a toll on the common man, wouldn't they clamour for a rate cut?

Unlikelier things have happened, even in tax reform. As President Reagan observed when introducing his

pioneering measures, “there are three stages of reaction to a new idea like our tax proposal. First stage is: ‘It's crazy. It'll never work. Don't waste my time.' The second: ‘It's possible, but it's not worth doing.' And finally: ‘I've always said it was a good idea. I'm glad I thought of it'.”

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Hedge funds

All locked-up

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Once investors fought to get into hedge funds. Now some may be fighting to get out

Get article background

NO ONE wants to be stuck in a house when the floor is shaking underfoot, however palatial the mansion. Some investors have found this out the hard way as subprime-related troubles have rattled parts of the hedge-fund industry, leading to steep losses at funds such as Sowood Capital, Basis Capital and United Capital Asset Management. Until recently, investors were jostling with each other to gain access to the best alternative investments. Of those who got in, some now face the opposite problem: how to get out.

That is because, in their eagerness to invest, they agreed to long “lock-ups”, signing contracts with fund managers to keep their money in the fund for a minimum period before redeeming it. In a hard lock-up, investors have no right to redeem before their time is up; in a soft lock-up, they can get out early but have to pay a redemption fee of, say, 3-5%.

The cachet of investing in the best hedge funds meant a few celebrated managers were able to bargain for the longest lock-up periods. One of the most prestigious recently secured a ten-year lock-up—enough to withstand a Biblical plague, let alone a private-equity cycle. ESL Investments, the firm run by hotshot manager Eddie Lampert, has set up a fund with a five-year lock-up. Most funds manage only one to two years.

For managers, the benefits of lock-ups are clear. A fund with few restrictions on getting out attracts investors who like liquidity, but the ability to redeem money quickly can turn the fund into a ready source of cash when markets turn sour: investors tend to sell what they can, rather than what they should. Also the best trades often crop up at the point when investors are most nervous and markets are most volatile. As Dan Higgins of Fauchier Partners puts it, all managers want “dry powder in times of market stress.”

Lock-ups have also enabled hedge funds to shift from quick-fire investment strategies such as convertible and merger arbitrage, where competition is fierce, into more exotic and less liquid areas. They include distressed debt, activist investing, lending, and buy-outs. It would be foolish for a manager to make a three-year loan when his own investors could cut and run within a year; the mismatch of assets and liabilities could be ruinous.

For investors, too, there are reasons why lock-ups make sense. Emanuel Derman of Prisma Capital Partners, a fund of hedge funds, has shown that for many strategies good hedge funds continue to outperform their peers and bad funds tend to remain in the same rut; there is little reversion to the mean. So investors in a good fund ought to be happy to stay put. Mr Derman calculates that an investor is likely to earn about 1% more per year when choosing a three-year lock-up over a more liquid one-year lock-up. But his evidence suggests that the lock-up premium reaches a limit of around 3% a year by the seventh year (so there's not much additional benefit from risking your money for longer).

And for those who are rattling the cages to get out, an escape network of sorts has sprung up. Companies such as Hedgebay Trading have developed a secondary market for hedge-fund shares. Typically, an investor can sell a stake for 1-5% less than its current value to another investor in order to leave a hedge fund. If the fund is particularly popular, the investor might even earn a premium on his stake. As for disasters like the recent Bear Stearns' casualties—bidders were offering five cents on the dollar for one fund in early July. It later emerged the shares were worthless.

So is an investor with a short lock-up safe? Not really. Not all investors get the same lock-up terms, and the ones with the longest—however short that may be—could be the last to collect their money. Also, fund managers have the ability to invoke “gates” , which restrict how much can be withdrawn in any period, as the managers of Basis Capital did recently.

Further fine print may give fund managers even more discretion. An activist fund with a big shareholding in a company may find there are regulations barring the sale of its stake during a takeover battle, for example. That constraint may enable the manager to stop or limit redemptions, says David Efron of Schulte Roth & Zabel, a law firm with many hedge-fund clients. In hedge funds, as in life, there is rarely a get-out-of-jail-free card when you need one.

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Buttonwood

Cold Turkey

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Why some emerging markets may suffer from withdrawal

WHEN investors get twitchy, developing countries are usually the first to pay the price. In the financial swoon of May-June 2006, emerging-market shares fell 25%. The current sell-off may be even more dangerous because it follows a recent bout of exuberance. According to Morgan Stanley, inflows into emerging-market funds hit a record $11.1 billion in the four weeks to July 25th.

So it is possible that some emerging markets could be among the worst casualties of the latest wave of risk aversion. In particular, it is time to worry about some of the beneficiaries of the “carry trade”.

The trade assumes that markets are irrational. Investors who succumb to its lure borrow in low-yielding currencies, like the yen, and invest in higher-yielding assets. This is a relatively recent phenomenon. In the 1970s, low-yielding currencies were highly coveted; the Swiss were able to offer negative interest rates by charging people to hold bank accounts.

In theory, the long-term expected return from a currency carry trade should be zero, since the assets should only be offering a higher yield because of their higher risk. In practice, however, investors have been making money from the carry trade for years. This may well be due to the “Great Moderation” in the world economy. In many countries both growth and inflation have been more stable than expected. Economies with a poor inflation record have thus tended to overcompensate investors for the risk they have taken.

But the carry trade has also allowed some countries to get away with economic policies that they might never have dreamed of in the 1980s or early 1990s. As this column recently noted, Latvia and Iceland have been running current-account deficits of 25-30% of GDP without suffering a currency crisis.

Turkey has been another beneficiary. Its current-account deficit has not hit the Icelandic extreme but, at around 7.5% of GDP, it is still a gaping hole. However, short-term interest rates of 18.7% have encouraged investors to take the risk of buying the currency; the lira has risen 18% against the dollar in the past year.

A strong currency has created some odd-looking anomalies. Tim Lee of pi Economics calculates that, in dollar terms, the Turkish economy has grown at a 22% annual rate over the last five years; in terms of GDP per head, Japan was 14 times richer than Turkey in 2001; now it is only five times better off. On that basis, Mr Lee suggests, Turkey looks the kind of miracle economy that puts China to shame.

A strong currency has encouraged Turkish companies to borrow abroad. Mr Lee cites figures from the Istanbul Chamber of Industry showing that foreign borrowings had more than doubled to $72 billion between 2003 and 2006. Were the lira to collapse, the cost of repaying dollar-denominated debts would be a big burden for Turkish companies.

Currency strength is also the “wrong” response to Turkey's current-account deficit because it will make the country's exports less competitive. As a result, Mr Lee reckons the deficit may head towards 10% of GDP during the second half of this year.

Until recently, markets have been reluctant to punish Turkey for its dodgy economic fundamentals, perhaps hoping it will be a long-term winner if it manages to pull off greater integration with Europe's economies. The business-friendly policies of Recep Erdogan, the recently re-elected prime minister, have also helped sentiment. Neil Shearing, emerging-Europe economist at Capital Economics, reckons that Turkish bonds ought to trade at a premium of nearly three percentage points to Treasury bonds, rather than their current two-point spread.

However, investors may at last be opening their eyes to the risks in Turkey. Figures from Morgan Stanley show that, in dollar terms, it was the worst performing emerging stockmarket in the week to July 27th, falling 12%.

Turkey may have been helped by the perception that, because many emerging markets have improved their economic positions, all of them are less risky. Emerging-market bond spreads (the excess rate over Treasury-bond yields) reached a record low of around one-and-a-half percentage points in June. When investors were only getting 6% for lending money to investment backwaters such as Peru, a 6.7% yield from Turkey must have looked like a bargain.

But it is in the nature of emerging markets that, every so often, they kick investors in the teeth. This looks like being one of those moments. Of course, within 12 months, investors are bound to be back, their smiles expensively restored. Fast economic growth and high yields are just too alluring.

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Catastrophe bonds

Ports and storms

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Retail investors bet that nature will be calmer than the markets

WITH the planet warming and the weather doing outlandish things, it is odd to think that bets on natural disasters might turn out to be a safe haven for investors. But that is how they may be marketed as turmoil grips global financial markets. Correlations between asset classes are appearing in unexpected ways, but are unlikely to reach holders of catastrophe bonds, the securities issued by insurance companies that pay tempting yields but can lose their value in the event of floods, earthquakes and the like. Investors in “cat” bonds can shrug off the subprime mortgage mess, the price of oil, or any other misfortune that might arise—except those caused by an act of God.

In the past, cat bonds were available only to large institutions, which typically acquired them directly from insurance companies. But recently, Pioneer Investments, an American fund-management firm, opened the first mutual fund to give individuals exposure. If the fund is a success and spawns copycats, even insurance-policy buyers could reap rewards; the greater appetite may lower yields, making them cheaper than reinsurance—a saving that could be passed onto consumers.

Until recently, the market for cat bonds was minuscule. Thanks to a decade without major natural disasters following the 1994 Northridge earthquake, property and casualty insurers were awash with capital and had little need to hunt for more. But after hurricanes Katrina, Rita, and Wilma caused over $60 billion in claims and sopped up much of the world's available reinsurance capacity, insurers have increasingly sought to share their risk with the markets. Last year, they more than doubled their issuance of cat bonds, from under $2 billion in 2005 to $4.7 billion.

This increased supply has made cat bonds more attractive to investors. According to Charles Melchreit, a portfolio manager of the Pioneer fund investing in them, a typical cat bond pays a coupon of 12%, nearly twice as much as the non-investment-grade sovereign debt of an emerging market like Brazil. On average, he argues, losses are likely to be minimal—lower, at least, than from the risk of default on high-yield corporate debt. Only once, during the exceptionally bad hurricane season of 2005, has the value of the bonds been wiped out entirely.

The securities' main drawback is illiquidity: there is virtually no secondary market for cat bonds, as they tend to be gobbled up by buy-and-hold investors eager for the yield. But Pioneer is seeking to expand the pool of buyers. “Traditionally, they have been a little closed club for hedge funds, which have served the needs and interests of high-net-worth people,” says Ken Taubes, director of fixed income at Pioneer. “We're trying to democratise them.” Currently, the exposure of the fund's investors to cat bonds is small and part of a broader portfolio. But Pioneer hopes to launch a larger, pure cat-bond vehicle if the first fund is a success.

It will not be easy. Barring another mega-disaster like Katrina, reinsurance capacity is likely to continue recovering over the next few years, giving insurers fewer reasons to issue cat bonds. Investors, meanwhile, might like an alternative to tempestuous markets. But betting on the natural environment is a highly unpredictable strategy, too.

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China's economy

Be careful what you wish for

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Is inflation China's latest export?

Get article background

CHEAP imports from China have helped to hold down prices in America and other developed economies. However, a flurry of recent reports suggesting that Chinese wages and prices are surging have triggered fears that China is now exporting inflation, rather than deflation, to the rest of the world.

In May the 12-month change in the average price of American imports from China turned positive for the first time since the index was first published in 2004; it showed a rise of 0.6% in June. The subsequent news that China's rate of consumer-price inflation shot up to 4.4% in June has added to concerns that its red-hot economy is now fuelling rather than dampening global inflation.

Such fears are overblown. The main reason for the upturn in China's export prices is not rampant domestic inflation, but the rise in the yuan. As the dollar has weakened, America's import prices from most countries have accelerated over the past 18 months (see chart), especially from Europe. Since July 2005 the yuan has gained 9% against the dollar, so in industries such as clothing, where profit margins are slim, exporters have been forced to raise their prices in dollar terms. According to Mingchun Sun and Rob Subbaraman at Lehman Brothers, the dollar prices of Chinese clothing exports were about 4% higher in the first half of 2007 than a year ago, roughly matching the rise in the yuan. If Beijing gives in to Washington's demands for a much bigger revaluation, Americans must expect further price rises.

It is the weak dollar, not cantering cost inflation in China, that is to blame for higher American import prices. China's manufacturing costs and export prices in yuan terms are still falling overall. The surge in consumer-price inflation is entirely due to higher food prices, which do not affect export prices.

Nor is China close to running out of cheap labour, as some commentators suggest. There are shortages of managers and skilled workers, but it could take at least another decade before China's surplus rural labour is fully absorbed by industry. It is true that average wages have jumped by 15% over the past year, but productivity in manufacturing has been growing faster still, so unit labour costs have fallen. Moreover, those productivity gains—ie, a higher value of output per worker—partly reflect a shift in the mix of exports towards higher-value goods. This shift, misleadingly, makes it look as if China is charging more for its exports.

In any case, many worries about the effects of rising Chinese export prices are based on a misunderstanding. The impact of a low-cost producer, such as China, on global inflation depends more on differences in price levels between countries than on the rate of change in its export prices. China has helped to hold down global inflation not because its prices have been falling, but because its goods are so cheap and are gaining global market share. This pushes down the prices of all competing goods sold in domestic markets.

Even if China's export prices start to rise, they will curb America's inflation rate as long as they remain lower than the global average and China's share of America's market continues to rise. The real threat to America's inflation is not that Chinese export prices start to rise modestly, but that Congress is short-sighted enough to impose protectionist measures which prevent American consumers from continuing to buy cheap Chinese imports.

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Economics focus

In praise of usury

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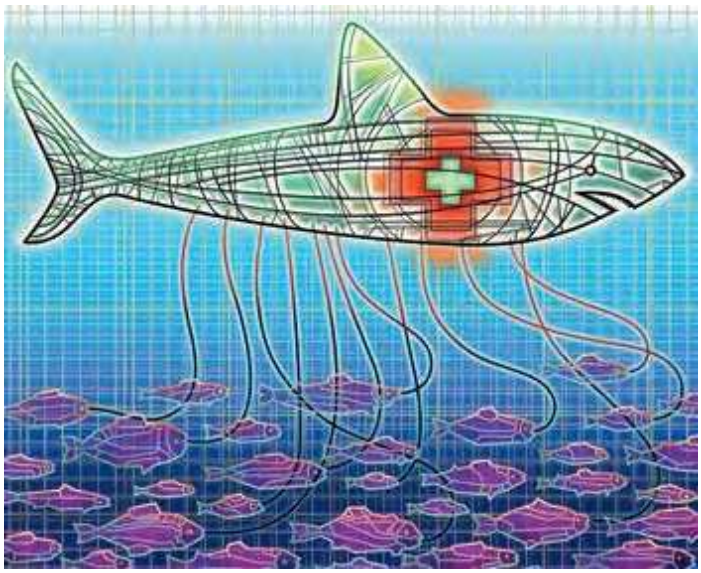
JAC



Ignore credit snobs. It is no sin to profit from lending to the poor

IN DANTE'S “Divine Comedy”, usurers are consigned to a flaming desert of sand within the seventh circle of hell. Attitudes have since softened a bit. Microcreditors, who offer small loans to self-employed poor people, enjoy hallowed reputations. One has even ascended to the rank of a Nobel laureate. But lending to the poor is still considered distasteful whenever it is pricey, short-term and profitable. In America, for example, many activists are quick to damn “payday” lenders, who may charge high fees for offering cash advances on a worker's next pay cheque.

Why this hostility? To profit from lending to the poor, critics say, is to prey on the most vulnerable, at their most vulnerable moment. Faced with desperate customers, loan sharks can charge well over the odds, even when the risk of default is slight. The money they proffer is often squandered on spurious consumption, critics say, rather than productive investments that would help the borrower repay his debts. Easy credit thus tempts people into a damaging spiral of indebtedness.

That may be enough for Dante. But economists take a bit more convincing. If loans hurt the poor, why do they take them? Surely they are capable of looking after their own interests. Alex Tabarrok, an influential economics blogger, thinks the anti-usury lobby are “credit snobs”, who think that credit is something only the rich can handle.

Some critics of usury appeal to psychology not snobbery, however. The “behavioural” economists have shown that people's decisions often conflict with the plans they had laid for themselves. When planning for the future, people are willing to defer gratification, forgoing smaller, earlier rewards in favour of bigger, later ones. But when choosing in the present, they give up huge future benefits for immediate gratification. If they anticipate their own weakness, people may quite rationally chop up their credit cards, or tie money up in illiquid assets. It is the financial equivalent of avoiding restaurants with irresistible desserts.

Some governments have concluded that by denying expensive credit to the poor, they would be doing them a favour. In America, many states have crimped payday lending by imposing anti-usury laws or restrictions on lending terms. In Japan, interest-rate caps have, in effect, wiped out much of the formal consumer-lending industry.

In poorer countries, governments are ambivalent. On the one hand, they are anxious to subsidise

microfinance, extending small-business loans further than the market allows. But they take the opposite attitude towards consumer credit, imposing interest-rate caps that stop lenders reaching as many people as they otherwise might. South Africa this year tightened curbs on reckless lending and overborrowing.

Widening the circle

Is the South African government right to think that credit has gone too far? Rather than relying on theology or theory to answer this question, a recent working paper offers some rare evidence. Dean Karlan, a Yale economist who is co-director of the Financial Access Initiative, and Jonathan Zinman, of Dartmouth College, studied a profit-seeking lender that served some of South Africa's poorer neighbourhoods. Suspecting that its credit standards were too strict, the lender was willing to experiment with a looser provision of credit. It asked its loan officers in Cape Town, Port Elizabeth and Durban to reconsider 325 out of 787 applicants who had narrowly missed out on approval for a loan. The lucky 325 were chosen at random—nothing distinguished them from the remaining 462, except the luck of the draw. This allowed the researchers to establish a causal link between the loan and changes in the lives of the applicants.

Most of the new customers took a four-month loan at an annual interest rate of about 200%: a 1,000-rand loan, for example, would be repaid in four monthly instalments of 367.50 rand. For the bank, the study proved the wisdom of stretching its lending limits. The new clients were profitable, if not as profitable as the borrowers already on their books. The authors reckon the bank made a gain of at least 201 rand per loan.

Did these profits come at the expense of the poor? On the contrary. Despite the demanding terms on offer, those reconsidered for a loan seemed to prosper. Six to twelve months later, they were less likely to go hungry, and their chances of being in poverty fell by 19%. Not coincidentally, they were also more likely to have kept their jobs, perhaps because the credit helped them to overcome emergencies that might otherwise have forced them to abandon their posts. About a fifth of them, for example, spent their loan on transport, such as buying or repairing a car that they might have needed to get to work.

The results were not all as happy: the authors found some evidence of higher stress, especially among female borrowers. But people also reported more control over their lives and a more positive outlook. Perhaps the easier access to credit allowed them to take a longer-term perspective, even if “longer term” is measured in months or weeks rather than the more conventional notion of decades.

Contrary to the fears of the credit snobs, the readier access to credit did not tempt the new customers into a debt trap. Over 15-27 months, those reconsidered for a loan were more likely to have a formal credit score. And this score suffered no harm as a result of their easier borrowing.

Overall, the study suggests that profit-seeking lenders do not deserve the fate Dante reserved for them. Far from tempting the poor into unpayable debt, they help them keep their jobs, put food on the table, and build up a credit history. The authors show that poor people can make good use of borrowed money, even if they sometimes struggle to demonstrate this creditworthiness to lenders. If not hell, that is a kind of purgatory.

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Evolutionary psychology

Blatant benevolence and conspicuous consumption

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From The Economist print edition

Charity is just as “selfish” as self-indulgence

Illustrations

GEOFFREY MILLER is a man with a theory that, if true, will change the way people think about themselves. His idea is that the human brain is the anthropoid equivalent of the peacock's tail. In other words, it is an organ designed to attract the opposite sex. Of course, brains have many other functions, and the human brain shares those with the brains of other animals. But Dr Miller, who works at the University of New Mexico, thinks that mental processes which are uniquely human, such as language and the ability to make complicated artefacts, evolved originally for sexual display.

One important difference between peacocks' tails and human minds, of course, is that the peahen's accoutrement is a drab affair. No one could say the same of the human female psyche. That, Dr Miller believes, is because people, unlike peafowl, bring up their offspring in families where both sexes are involved in parenting. It thus behoves a man to be as careful about choosing his wife as a woman is about choosing her husband.

Both sexes, therefore, have reason to show off. But men and women will have different criteria for making their choices, and so the sexual-display sides of their minds may differ in detail.

Testing this hypothesis will be a long haul. But in a paper he has just published in the *Journal of Personality and Social Psychology*, in collaboration with Vladas Griskevicius of Arizona State University, Dr Miller goes some way towards it. He, Dr Griskevicius and their colleagues look into two activities—conspicuous consumption and altruism towards strangers—to see if these support the “mating mind” hypothesis, as Dr Miller has dubbed his idea. Their conclusion is that they do.

Things are seldom what they seem

Altruism, according to the text books, has two forms. One is known technically as kin selection, and familiarly as nepotism. This spreads an individual's genes collaterally, rather than directly, but is otherwise similar to his helping his own offspring. The second form is reciprocal altruism, or “you scratch my back and I'll scratch yours”. It relies on trust, and a good memory for favours given and received, but is otherwise not much different from simultaneous collaboration (such as a wolf pack hunting) in that the benefit exceeds the cost for all parties involved.

Humans, however, show a third sort of altruism—one that has no obvious pay-off. This is altruism towards strangers, for example, charity. That may enhance reputation. But how does an enhanced reputation weigh in the Darwinian balance?

To investigate this question, the researchers made an interesting link. At first sight, helping charities looks to be at the opposite end of the selfishness spectrum from conspicuous consumption. Yet they have something in common: both involve the profligate deployment of resources.

That is characteristic of the consequences of sexual selection. An individual shows he (or she) has resources to burn—whether those are biochemical reserves, time or, in the human instance, money—by using them to make costly signals. That demonstrates underlying fitness of the sort favoured by evolution. Viewed this way, both conspicuous consumption and what the researchers call “blatant benevolence” are costly signals. And since they are behaviours rather than structures, and thus controlled by the brain, they may be part of the mating mind.

There is, of course, a lot of evidence for the first part of this conjecture. Everybody knows that fast cars attract fast women. The second, though, may come as a surprise. So the team did an experiment to compare them.

They divided a bunch of volunteers into two groups. Those in one were put into what the researchers hoped would be a “romantic mindset” by being shown pictures of attractive members of the opposite sex. They were each asked to write a description of a perfect date with one of these people. The unlucky members of the other group were shown pictures of buildings and told to write about the weather.

The participants were then asked two things. The first was to imagine they had $5,000 in the bank. They could spend part or all of it on various luxury items such as a new car, a dinner party at a restaurant or a holiday in Europe. They were also asked what fraction of a hypothetical 60 hours of leisure time during the course of a month they would devote to volunteer work.

The results were just what the researchers hoped for. In the romantically primed group, the men went wild with the Monopoly money. Conversely, the women volunteered their lives away. Those women continued, however, to be skinflints, and the men remained callously indifferent to those less fortunate than themselves. Meanwhile, in the other group there was little inclination either to profligate spending or to good works. Based on this result, it looks as though the sexes do, indeed, have different strategies for showing off. Moreover, they do not waste their resources by behaving like that all the time. Only when it counts sexually are men profligate and women helpful.

That result was confirmed by the second experiment which, instead of looking at the amount of spending and volunteering, looked at how conspicuous it was. After all, there is little point in producing a costly signal if no one sees it.

As predicted, romantically primed men wanted to buy items that they could wear or drive, rather than things to be kept at home. Their motive, therefore, was not mere acquisitiveness. Similarly, romantically primed women volunteered for activities such as working in a shelter for the homeless, rather than spending an afternoon alone picking up rubbish in a park. For both sexes, however, those in an unromantic mood were indifferent to the public visibility of their choices.

These two studies support the idea, familiar from everyday life, that what women want in a partner is material support while men require self-sacrifice. Conspicuous consumption allows men to demonstrate the former. Blatant benevolence allows women to demonstrate the latter. There is, however, a confounding observation. The most blatant benevolence of all, that of billionaires giving away their fortunes and heroes giving away (or at least risking) their lives, is almost entirely a male phenomenon.

To examine this, the team did another experiment. They found that when requests for benevolence were financial, rather than time-consuming, romantically primed men were happy to chip in extravagantly. Giving money to charity is thus more akin to conspicuous consumption than it is to blatant benevolence. The primed men were also willing (or at least said they were willing) to act heroically as well as spend—but only if the action suggested was life-threatening. Women, romantically primed or not, weren't.

Heroism, of course, is a pretty high-risk strategy. But if you survive, you really have proved the quality of your genes. As the old saw has it, faint heart never won fair lady. On the other hand a soft heart, it appears, wins a gentleman.

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Neuroscience and genetics

Lest we forget or lest we remember?

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More Swiss than Rwandans have a gene for unusually good emotional memory

PEOPLE remember emotionally charged events more easily than they recall the quotidian. A sexual encounter trumps doing the grocery shopping. A mugging trumps a journey to work. Witnessing a massacre trumps pretty well anything you can imagine.

That is hardly surprising. Rare events that might have an impact on an individual's survival or reproduction should have a special fast lane into the memory bank—and they do. It is called the α2b-adrenoceptor, and it is found in the amygdala, a part of the brain involved in processing strong emotions such as fear. The role of the α2b-adrenoceptor is to promote memory formation—but only if it is stimulated by adrenaline. Since emotionally charged events are often accompanied by adrenaline secretion, the α2b-adrenoceptor acts as a gatekeeper that decides what will be remembered and what discarded.

However, the gene that encodes this receptor comes in two varieties. That led Dominique de Quervain, of the University of Zurich, to wonder if people with one variant would have better emotional memories than those with the other. The short answer, just published in *Nature Neuroscience*, is that they do. Moreover, since the frequencies of the two variants are different in different groups of people, whole populations may have different mixtures of emotional memory.

AP

Trying to forget it

The reason Dr de Quervain suspected the variants might work differently is that the rarer one looks like the commoner one when the latter has a memory-enhancing drug called yohimbine attached to it. His prediction, therefore, was that better emotional memory would be associated with the rarer version.

And that did, indeed, turn out to be the case in his first experiment. This involved showing students photographs of positive scenes such as families playing together, negative scenes such as car accidents, and neutral ones, such as people on the phone. Those students with at least one gene for the rarer version of the protein (everyone has two such genes, one from his father and one from his mother) were twice as good at remembering details of emotionally charged scenes than were those with only the common version. When phone-callers were the subject, there was no difference in the quality of recall.

That is an interesting result, but some of Dr de Quervain's colleagues at the University of Konstanz, in Germany, were able to take it further in a second experiment. In fact, they took it all the way along a dusty road in Uganda, to the Nakivale refugee camp. This camp is home to hundreds of refugees of the Rwandan civil war of 1994.

In this second experiment the researchers were not asking about photographs. With the help of specially trained interviewers, they recorded how often people in the camp suffered flashbacks and nightmares about their wartime experiences. They then compared those results with the α2b-adrenoceptor genes in their volunteers. As predicted, those with the rare version had significantly more flashbacks than those with only the common one.

Besides bolstering Dr de Quervain's original hypothesis, this result is interesting because only 12% of the refugees had the rarer gene. In Switzerland, by contrast, 30% of the population has the rare variety—and the Swiss are not normally regarded as an emotional people.

Whether that result has wider implications remains to be seen. Human genetics has a notorious history of jumping to extravagant conclusions from scant data, but that does not mean conclusions should be ducked if the data are good. In this case, the statistics suggest Rwanda may have been lucky: the long-term mental-health effects of the war may not be as widespread as they would have been in people with a different genetic mix. On the other hand, are those who easily forget the horrors of history condemned to repeat them?

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Medicine

No-iron rations

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In the future, infections may be cured by diet, as well as drugs

CONTROLLING infectious disease is an arms race. Pharmacists develop drugs against particular pathogens. Those pathogens evolve resistance. Better drugs are developed. The pathogens evolve a bit more. And so on. Time, perhaps, for some creative thinking.

One person doing such thinking is Val Smith of the University of Kansas. In a paper just published in the *Journal of Integrative and Comparative Biology* he argues that the future of disease control may lie not in better antibiotics but in cutting off the supply of nutrients to the pathogens by manipulating a patient's diet.

Obviously, you cannot stop feeding someone entirely when they are ill, but there might be nutrients which the patient could do without but the pathogen could not. Dr Smith scoured the university's library, looking for experiments that had studied the effect of diet on animals suffering from infectious diseases. He found three specific examples, and one more general case, where changes in diet appeared to have had beneficial effects. He suggests, therefore, that it might be worth trying the same thing in people.

The first of the specific studies was on *Salmonella*, a bacterium found in spoilt food. In this experiment, infected mice were fed on diets that contained variable amounts of protein, carbohydrate and fat. The amount of fat did not make any difference, but the more carbohydrate there was in a diet, the more frequently the mice died of their infection. Conversely, mice on high-protein diets were more likely to live.

A high-protein diet, though, is not always the right route to take. In the second study Dr Smith identified, rats infected with *Plasmodium berghei*, the rodent version of malaria, were less likely to die of the disease if fed low-protein diets.

The third study examined a specific nutrient, a sugar called fructose that is abundant in fruit. In this case a low-fructose diet kept infection with a parasitic worm called *Moniliformis dubius* under control in rats.

The most promising line of all, though, is to control an animal's intake of iron. Many experiments have shown a fierce competition for this element between bacterial, fungal and protozoan pathogens and their hosts. Fortunately, this is a competition where the host appears to have the advantage. In situations where iron is scarce, the bodies of mice and rats (and presumably, by extension, people) seem able to collect the nutrient more efficiently than pathogens do.

The trick, Dr Smith suggests, is to cut patients' iron intake to the minimum necessary for survival. Theoretically, that would leave nothing for pathogens to make use of, thus suppressing infection and restoring, as it were, an iron constitution.

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Materials science

Opal fruits

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Opalescent plastic could prove both pretty and handy

WILLIAM MORRIS (the wallpaper designer, rather than the carmaker) suggested that nothing should have a place that is not known to be useful or believed to be beautiful. Opals, though, might be both. A group of researchers from the University of Southampton, in England, and the German Plastics Institute in Darmstadt, led by Jeremy Baumberg, have discovered how to create a plastic with the gemstone's iridescent properties. Their invention could be used to make a sparkling substitute for paint, banknotes that are hard to counterfeit and chemical sensors that can act as visible sell-by dates.

Opals get their milky sheen and rainbow sparkle from the way light is scattered by the tiny crystals that form them. These crystals are stacked in what is known as a face-centred cubic structure. This means that the constituent atoms are arranged in a lattice of cubes, with one extra atom sitting at the centre of each cube's six faces. Light entering this lattice gets bounced around in ways that generate colour by reinforcing the peaks of some wavelengths and cancelling out those of others.

For many years researchers have been trying to develop a synthetic material with the same light-scattering properties as an opal, by etching patterns into various materials. That approach has failed. Instead, Dr Baumberg has built his opalescent material from scratch. He and his team grew tiny polystyrene spheres until they were some 200 nanometres across, before hardening them with a blast of heat. They then coated the spheres with a sticky polymer before heating them again. As the mixture was baked, the spheres moved naturally into a face-centred cubic structure.

The result is a flexible film of crystals with opalescent properties that can be used to coat malleable surfaces, producing attractive iridescent hues. The size of the spheres can be tailored to scatter particular wavelengths of light—a useful property for security applications in which it is important that materials can be identified precisely. Moreover, when the film is warped, the spaces between the crystals change—and the colours produced change with them. These two properties make opalescent film an obvious material for currency. Banknotes containing it would produce distinctive colours when stretched, unlike counterfeits made from other materials.

To use the film to detect food spoilage, Dr Baumberg proposes adding a sprinkle of carbon particles even smaller than the polystyrene spheres. These would nestle in the spaces between the spheres and cause the material to scatter light from even more angles, making it yet more iridescent. This arrangement could be “tuned” to react to specific toxic chemicals. Food packaging made from such a material would thus change colour as the rot set in.

Such packaging need not be expensive. The polymer spheres and carbon particles arrange themselves spontaneously into the correct crystal structure when encouraged by a little heat, so manufacturing opalescent film should be easy. Indeed Merck, a German chemical company that was a partner in the research, has already produced rolls of the stuff a metre wide and 100 metres long. Perfect for wallpaper.

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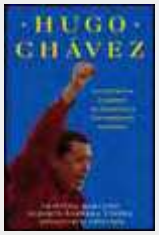
Latin America

Man and superman

Aug 2nd 2007
From The Economist print edition

Meet the real Hugo Chávez, military caudillo and political televangelist

Hugo Chávez: The Definitive Biography of Venezuela's Controversial President
By Cristina Marcano and Alberto Barrera Tyszka
Translated by Kristina Cordero



Random House; 368 pages; $27.95

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AP

Get article background

IN THE eight years since he was first elected Venezuela's president, Hugo Chávez has become the most controversial political figure in Latin America. He has also, as Moisés Naím, a former Venezuelan minister who now edits *Foreign Policy*, points out in his introduction to this biography, bracketed himself with Fidel Castro as one of the very few from the region to have become a household name.

He has achieved this partly through sheer verbal effrontery, as in his badmouthing of George Bush. But Mr Chávez's fame stems, too, from his oil-backed claims to be leading a new revolutionary project of "21st-century socialism" that tears up the nostrums of economic liberalism. His fans see this as a model for the developing world. To his opponents, he is an elected dictator who is destroying his country's democracy and, through reckless public spending and controls on private business, its economy.

So there is already much mythology surrounding Mr Chávez. But the man himself has remained elusive. This highly readable biography, first published in Spanish in Venezuela in late 2004, is not “definitive”. But it is an essential starting point to understanding Mr Chávez, and thus to seeing what lies ahead for his country. Cristina Marcano, a Venezuelan journalist, and Alberto Barrera, her novelist husband, interviewed a number of people who at varying times have been close to Mr Chávez. They also draw on the little-publicised work of other researchers, especially regarding the plotting in which Mr Chávez was involved as an army officer. They offer a scrupulously balanced account of a man whose belligerence has polarised opinion in his country and beyond.

The Hugo Chávez who emerges from their book is a complex and astute populist. He is first and foremost a military man. Born into respectable poverty in the tropical lowlands, he saw the army as a route to advancement—as do so many lower-middle-class provincial youths in Latin America. Once politics had replaced baseball as his primary passion, his heroes would be nationalist military rulers such as Peru's General Juan Velasco and Panama's Omar Torrijos, rather than Mr Castro or Che Guevara. Indeed, Mr Chávez distrusts civilians; in government, he has placed many military officers in civilian jobs.

As a politician Mr Chávez is a cool strategist, though a sometimes reckless tactician. He is a natural showman with the talents of a televangelist. The authors are surely right when they say that the “root of Chávez's power resides in the religious and emotional bond” he has forged with ordinary Venezuelans, especially poorer ones. In the tradition of the televangelist, that bond has survived its creator's metamorphosis from austere crusader against corruption to a man who clearly enjoys power and its perquisites. Nowadays, the book notes, Mr Chávez sports designer clothes and Cartier watches—and a growing personality cult.

This bond has allowed him to pull off the remarkable trick of posing as the leader of the opposition to his own incompetent government. Along with all this goes a certain kookiness: the authors cite several sources who say that Mr Chávez believes himself the reincarnation of Ezequiel Zamora, a 19th-century *caudillo*, and that he leaves an empty chair at meetings for the spirit of Símon Bolívar, the hero of Venezuela's independence.

Mr Chávez has also enjoyed much luck. He has been underestimated by opponents. He is still in power today because of a massive oil windfall. Had his predecessors benefited from today's oil prices Venezuelans would almost certainly not have abandoned their 40-year experiment with a two-party system in favour of an outsider like Mr Chávez.

The authors have relatively little to say about their subject's economic and social policies. But they are particularly useful in tearing away the mythology surrounding the most controversial episode in Mr Chávez's presidency. In their account of the failed coup that briefly toppled the president in April 2002, they show that the army's commanders rebelled when the president ordered them to repress a vast anti-government demonstration. Those same commanders then recoiled, restoring Mr Chávez to power after a conspiratorial group tried to use the confusion to decree an end to democracy.

In their righteous indignation over this conspiracy, Mr Chávez's acolytes gloss over the fact that their hero himself led a similar failed coup against an elected government ten years before. His intention, we are told, was to set up a military-dominated government which would shoot civilian politicians for corruption.

For this English-language edition, the authors have added a brief postscript to a narrative that stops with their subject's victory in a recall referendum in August 2004. At times their text seems dated. A man previously known “for moving nimbly through the terrain of ideological ambiguity” has in recent months swerved more decisively in the direction of state-socialism and a lifetime presidency. That is already limiting his appeal in Latin America, and among the left in Europe. Mr Chávez's closest allies nowadays are in Iran and Belarus. Mr Naím worries that Mr Chávez has “hit a global nerve that makes him internationally relevant”. Perhaps so, but only so long as Mr Bush is around to hate, and so long as the oil money lasts.

Hugo Chavez: The Definitive Biography of Venezuela's Controversial President.
By Cristina Marcano and Alberto Barrera Tyszka.
Random House; 368 pages; $27.95

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The Reformation

In pursuit of the old and pure

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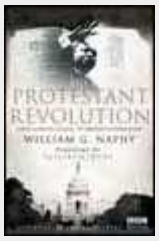
EARLY participants in what is usually called the Protestant Reformation did not set out to be reformers. Perhaps “The Protestant Revolution”, the title of William Naphy's book, is therefore a better label for the ecclesiastical rumblings that erupted at the beginning of the 16th century. For, as often seems to be the case, by pouring vinegar onto the theological limescale that the church had accumulated over the previous few centuries, the Reformation's main protagonists made something new by trying to go back to the beginning.

The Protestant Revolution: From Martin Luther to Martin Luther King Jr
By William Naphy



BBC Books; 303 pages; £19.99

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From the small group that issued a “protestatio” at the Diet of Speyer in 1529, supporting proposals by Martin Luther and Ulrich Zwingli, a many-headed movement grew. Its main characteristics—an emphasis on a direct relationship with Jesus and a strong belief among members of its various denominations that they alone have arrived at the correct reading of the New Testament—are still common to Protestantism today. These are low barriers to entry, which may help to explain the creative destruction that has characterised Protestant sects. Old ones die out and new ones are born, each convinced that the recent past has been an aberration and that what is needed is a return to an older, purer Christianity.

Mr Naphy believes that this powerful force for innovation can also be detected in the rise of classical liberalism in the 19th century and the civil-rights movement in the 20th (hence the forced symmetry of the book's subtitle). Maybe. But his story is remarkable enough when confined to the history of religion.

One of the appeals of this kind of long-view history is that patterns show up. In 1505 young Luther was so terrified by a thunderstorm that he vowed that he would join a monastic order if the forks of electricity avoided him. He kept his promise, which turned out to be bad news for monks everywhere. More than two centuries later, an area of low-pressure mixed with a dose of superstition had a similar effect on John Wesley, one of the 18th century's great religious entrepreneurs. Wesley was caught in a storm while crossing the Atlantic. His English companions were terrified, but a group of Moravians (a German Protestant sect) on board simply knelt before their maker and sang hymns. Their resolve had a profound effect on Wesley, who tried to inculcate the same certainty in his flock.

Or take the weakness for charismatic preachers that is one cause of Protestantism's institutional instability. Ted Haggard and Jimmy Swaggart, prominent American televangelists who preached piety in public and used prostitutes in private, were hardly pioneers here. Robert Pearsall Smith, a key figure in the Holiness Movement in 19th-century America, was defrocked at the height of his ministry when the gap between his preaching and his doing became public.

Protestantism has not travelled in a straight line but gone round in circles, each time creating something new while trying to get back to where it started. This talent for innovation will surely flourish as the movement grows rapidly outside Europe and North America, where its pioneers have created so many new Israels.

The Protestant Revolution: From Martin Luther to Martin Luther King Jr.
By William Naphy.
BBC Books; 303 pages; £19.99

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How to help the poorest

Springing the traps

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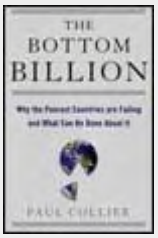
THIS slip of a book is set to become a classic of the “how to help the world's poorest” genre. Its author, Paul Collier, an Oxford economics professor, has spent 30-odd years puzzling mainly over sub-Saharan Africa and trying to work out why so many of its 48 countries have become basket cases. Crammed with statistical nuggets and common sense, his book should be compulsory reading for anyone embroiled in the hitherto thankless business of trying to pull people out of the pit of poverty where the “bottom billion” of the world's population of 6.6 billion seem irredeemably stuck.

Mr Collier reckons that most of the bottom billion live in 58 countries, 70% of them in Africa and most of the rest in Central Asia. Since the 1990s, more than 4 billion people in the poor world have begun to move out of the depths of poverty, some of them very fast. But the countries where the poorest live have barely grown at all since the 1970s.

Most of them are caught, as Mr Collier describes it, in one or more of four traps: wars, in which 73% of the poorest have been caught at one time or another; natural resources gone wrong (think of Nigeria and its oil), which accounts for about 30%; landlocked with bad neighbours (look at Chad); and the bad-governance-in-a-small-country trap (too many to name).

The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It
By Paul Collier



Oxford University Press; 224 pages; $28 and £16.99

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What comes most convincingly out of Mr Collier's book is that aid from the guilt-ridden West is not the answer, or at least not the main answer, and certainly not aid as it has so often been disbursed. For sure, aid has not been useless. “A reasonable estimate is that over the past thirty years [aid] has added one percentage point to the annual growth rate of the bottom billion,” he writes. “Aid has been a holding operation preventing things from falling apart.”

But Mr Collier is sceptical about the mantra of doubling aid to Africa, as the rich countries' leaders grandly promised at Gleneagles in Scotland two years ago. “The statistical evidence generally suggests that aid is subject to what is called ‘diminishing returns’,” he writes. Take Nigeria. Over the past 30 years or so, it has received some $280 billion “with depressingly little to show for it”. Plainly, vast dollops of aid have gone down the drain. In one of many statistical cameos, he cites a study showing that only 1% of €20m of aid sent to Chad actually reached the rural health clinics that were its intended target.

The rich world should concentrate, he argues, not on throwing aid at Africa, whether in budget support or projects, but on taking measures to encourage growth, above all through improving trade. The poor billions of East Asia have begun to race out of poverty not because of aid (very few received much) but because the conditions were created for their countries' economies to grow.

Mr Collier has an array of suggestions, all of them sensible, though some are unlikely to be taken up soon. For instance, he makes a bold case for military intervention to restore order in failing states (like Somalia); “the typical cost of a civil war”, he calculates, is “around $64 billion.” He also lists a raft of laws that should be enacted by Western governments, and of charters, mainly for poor countries to sign up to, that would provide a framework for setting things on the right track. Five suggested charters—for natural resources revenues, for democracy, for budget transparency, for post-conflict situations, and for investment—set out the sort of norms which, if adhered to by rich governments and poor ones, would help hoist the poorest out of their traps.

In the past two years, two famously opposing clarion calls, one from the aid-loving left, the other from the aid-is-always-wasted sceptical right, have been trumpeted. The one, Jeffrey Sachs's “The End of Poverty”, exaggerates the value of aid, especially in the massive dollops he proposes. The other, William

Easterly's “The White Man's Burden”, rightly mocks the delusions of the aid lobby but exaggerates the negative aspect. Mr Collier, though tending towards the second view, steers a masterly course between the two.

The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It.
By Paul Collier.
Oxford University Press; 224 pages; $28 and £16.99

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Art in Myanmar

A prisoner's tale

Aug 2nd 2007
From The Economist print edition

When lids of toothpaste tubes were brushes and stencils were carved out of soap

Get article background

THE junta that rules Myanmar is not known for its love of art. The generals do occasionally pay for the restoration of an historic temple or the painting of an edifying mural. But inevitably, the resulting work aims more to nourish their self-esteem than to reflect the life or concerns of ordinary Burmese.

The paintings of Htein Lin, a former Burmese dissident who has given up politics for art, serve as something of an antidote to the regime's propaganda. They are not, as some democracy activists might have hoped, a crusading attack on military rule. To the extent that they carry any ideological message, it is a simple insistence on freedom of expression. Above all, the collection of works on display at London's Asia House until October 13th is a record of the misery of life in the junta's prisons.

The life story of Mr Htein Lin (who can be seen above sitting in front of one of his paintings) mirrors the recent history of Burma, as Myanmar was known before the army changed its name. In 1988, while still at university and dabbling in painting, he helped to organise the political protests that brought down the dictatorial regime of the day. When the generals subsequently reasserted themselves, he fled to the jungle, along with many other idealistic students.

But disillusionment set in. The army overran the rebels' camps, neighbouring governments refused them refuge and the pressures of fear, hunger and disease bred discord. Some of Mr Htein Lin's comrades were executed by other rebels on suspicion of spying for the junta; Mr Htein Lin himself was tortured. He escaped and, renouncing politics, returned to university.

Politics, however, soon caught up with him again: the secret police intercepted a letter that, unbeknownst to Mr Htein Lin, mentioned his name as a possible recruit to the opposition's cause. A military tribunal slung him in prison. Six years later, as a result of a power struggle within the junta, he was released.

Throughout all this upheaval, Mr Htein Lin tried to keep painting. In the jungle, he was reduced to sketching in the sand with sticks. But the hardest place to pursue his calling was prison. Brushes, paints and paper were not allowed. At first, he used his fingers to spread dye from the prison factory over empty food packets. Gradually, however, he discovered that the *lungyis* (sarongs) of the prisoners' uniforms made the best canvases, while almost anything, from the lids of toothpaste tubes to the wheels of cigarette lighters could be used as brushes. Sometimes, he carved stencils out of bars of soap; at others, as in the self-portrait on display in the show, he applied his improvised paints with a syringe.

His fellow prisoners kept an eye out for guards while he painted. In exchange, he put on “exhibitions” for them in his cell block, or painted scenes they requested. He hid his work in his bedroll and bribed friendly guards to smuggle it out. Once, a guard mistook a series of abstract paintings as blueprints for an escape attempt and destroyed them.

Many of the paintings show snapshots of prison life: convicts crouched in subservient squats for inspections, or curled morosely in tiny cells. One, made for a friend who pined for a pretty view, depicts a sunset. Another, painted at the turn of the millennium, presents an imaginary firework display.

Mr Htein Lin says that the constant struggle to obtain supplies and hide his work kept him busy and distracted. Moreover, in the face of these and other obstacles, simply continuing to paint seemed like an act of defiance. It is good that this small but dignified protest succeeded. And it is even better that the paintings have now been drawn to the attention of a much wider audience, thanks in part to the artist's recent marriage to a British diplomat. But perhaps it is also a little depressing to see how the daily struggle to lay his hands on this and that has subsumed Mr Htein Lin's grander ambitions—as it has for so many other Burmese.

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Filming German history

The good German

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From The Economist print edition

Should Tom Cruise star in a film about Claus Schenk von Stauffenberg?

"IN MY entire childhood few events were as frequently discussed during supper at home as July 20th 1944," says Florian Henckel von Donnersmarck, a German director who won an Oscar earlier this year for his film about East German spies, "The Lives of Others". When talk turned to the plotters, led by Claus Schenk von Stauffenberg, who tried to assassinate Hitler on that fateful summer day, his mother, who was normally pretty rational, would cry "I admire nobody more than Stauffenberg, nobody, nobody!" For her generation the Stauffenberg plot was more than a failed plan that cost hundreds of lives, including those who just knew about it. It was the symbol of German resistance against Hitler, proof that in the darkest hours of German history, decency and honour survived.

AFP

Spot the real Stauffenberg (Cruise is on the right)

Young Germans still grow up with the hagiography of the plotters, but few outsiders now know who they were. This is likely to change. Two weeks ago in Berlin, Bryan Singer, an American director, began filming "Valkyrie" in which Tom Cruise, one of America's biggest stars, is playing Stauffenberg. When the film is released next year it will almost certainly be a box-office hit: millions of devoted fans watch any film so long as Mr Cruise is in it.

In Mr Henckel von Donnersmarck's view, Mr Cruise will do more for Germany's image than ten football World Cups. Yet Berthold von Stauffenberg, the plotter's son, is opposed to the film because he thinks in such cases drama always takes precedence over facts. Some German politicians have protested against the casting of Mr Cruise. And the defence ministry refused to allow filming at the Bendler Block, where Stauffenberg and others were executed, on the ground that the actor is a follower of Scientology, which in Germany is seen as a cult with totalitarian tendencies (it is not banned but is kept under surveillance).

But film-goers are aware that film-makers have poetic licence. So long as a director does not distort the essence of the story—a patriotic officer breaks his oath of loyalty to the German army to kill a tyrant—he must be allowed his interpretation of events. And Mr Cruise is an actor, not some contemporary version of Stauffenberg. Nobody, after all, probed Liam Neeson's ethics when he played Oskar Schindler in "Schindler's List", a film about the man who saved hundreds from death in a concentration camp.

The Stauffenberg group will always occupy a special place in German history. They were not perfect: some had the anti-Semitic prejudices common among members of their aristocratic class, others had sympathies for authoritarian regimes. But they gave their lives trying to get rid of one of the most evil regimes in history. As such they should be remembered by as many as possible for as long as possible. A film by one of America's best directors, with one of its most successful actors in the main role, may well help that legacy.

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Saudi fiction

But love's a malady without a cure

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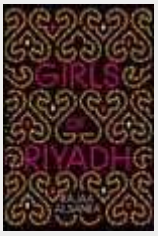
SAMIZDAT or Saudi chick-lit? Both, as it happens. Rajaa Alsanea's novel, set in the form of a gossipy internet blog about four upper-middle-class Saudi girls and their calamitous love lives, was officially banned in Saudi Arabia when it was published in Arabic two years ago (and a lawsuit was briefly filed against the author, fortunately away in America studying dentistry). But the book was still read, eagerly. Now, translated into English, it is easy to see why.

Girls of Riyadh
By Rajaa Alsanea



Penguin; 320 pages; $25.95.
Fig Tree; £12.99

Buy it at
Amazon.com
Amazon.co.uk

To begin with, the narrator's perky tone can be a bit irritating. And the girls, three of them university students, are so silly: dreaming non-stop of love and marriage, practising astrology, obsessed by the men they never, or hardly ever, are allowed to see but with whom they chirp like crickets throughout the night on their mobile phones.

But the tale soon has a darker side. The girls are still fixated but the reader grows protective of them, disgusted by the constraints that bind their lives—and outraged by the caddishness and/or feebleness of the men. One, for instance, makes love to Sadeem, the girl he is formally engaged to (couples are allowed to meet in the period between the signing of the contract and the wedding ceremony), but then promptly "divorces" her for her forwardness. Another, devotedly in love with half-American Michelle, drops her immediately when his mother feigns a heart attack at her foreign unsuitability. Only one of the four girls finds lasting happiness in both marriage and career.

The narrator does not rant at the state laws and family customs that dictate the way she and her fellows live, but bitterness drifts through. "Oh God," she e-mails, "we—the Girls of Riyadh—have been forbidden many things. Do not take the blessing of love away from us too!" In the end, however, one girl and her family have escaped to less suffocating Dubai and another, twice-jilted, has at last had enough of tricky Cupid. "[She] was finally cured of her love addiction. But it was a harsh experience that caused her to lose respect for all men." And about time too, judging from this odd, rather revealing novel.

Girls of Riyadh.
By Rajaa Alsanea.
Penguin; 320 pages; $25.95.
Fig Tree; £12.99

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Ingmar Bergman

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From The Economist print edition

Ingmar Bergman, film and theatre director, died on July 30th, aged 89

AP

WHEN he was filming “Winter Light”, in 1961, Ingmar Bergman made a tour of the churches of northern Sweden. He and his cinematographer, Sven Nykvist, would sit in the hard pews from 11 in the morning till two in the afternoon, watching the light change. In the Swedish winter, there was no sun. A dim grey illumination came from the clouds, casting no shadows. The subtleties of the shifting light entranced Mr Bergman, who decided that his whole film should be lit that way.

Strong sunlight, in contrast, filled his nightmares. A sudden lurid glare in his films—from a naked light, from an empty street—usually marked the entry into psychosis. That was why he never considered going to Hollywood to make movies, though by the 1950s his reputation as a film-maker was already impressive. He needed clouds, trees and net curtains veiling the light, softening it and making it move. He needed light in small increments: flaring and fading in a paraffin lamp, or dimming with extraordinary slowness on a face (as it dimmed on Liv Ullmann's face in “Persona”) until only a silhouette was left. From childhood, he had got up at six and noted the track of light on the wall opposite his window. After two months of darkness, a thread would reappear in January.

Lack of light was reinforced, for Mr Bergman, by the isolation of Swedish life: so few people scattered over a large country, in houses here and there in the forests and the fields where, round some dining table, decorous conversation hid the loneliness and tension that could not be expressed. In Mr Bergman's films, characters would often be silent, or scenes would unroll with no sound but the whimper of wind, the drip of water or, especially, the tick and chime of watches and clocks. He saw people as puppets, controlled by some pitiless force much as he, in boyhood, had controlled his own marionettes in his toy theatre, making Mr Punch jibber and squawk in nonsense-language. Life decayed towards “a state of absolute nothingness”, while his characters, clinging on, tried urgently and clumsily to communicate their feelings to each other.

He had been brought up with Lutheranism, a pastor's son subjected to sermons, beatings and high piety, and for all his protestations his films were full of it. His trilogy of the 1960s, “Through a Glass Darkly”, “Winter Light” and “The Silence”, were described by him as a “metaphysical reduction” in which God's

absence was unmasked. Without God, he turned to self-examination. His characters saw themselves through windows and in mirrors, divided selves gazing on their darker aspects or their pasts. He let his camera rest unsparingly on faces until all masks dissolved, and the lips and the eyes seemed to express some unaffected truth.

Sex and wild strawberries

The man himself often lived up to his bleak dream-world: lean, intense, racked by stomach complaints, and with a special fondness for the rugged limestone island of Faro, off Sweden's east coast, where he built a low stone house on an empty sweep of rock. Though he adored film, and had done so ever since he had swapped half his tin soldiers for his big brother's magic lantern, film-making made him “bleed too much”. Eight hours of waiting might be rewarded, he once said, with ten or 12 minutes of real creative work. He demanded total immersion both of his actors and of himself, and complete control of both the shoot and the script. He was sparing both with budgets and with film, and compulsively private.

Lighter moments surfaced sometimes. His long, lesser-known career in theatre directing, in Gothenburg, Malmo and Stockholm, included comedies alongside his favourite Strindberg. Explosions of directorial frustration were followed by gales of laughter. Pretty women surrounded him, several of whom he married and two of whom (Ms Ullmann and Bibi Andersson) starred in “Persona”, in 1966, as different aspects of the same self. He delighted in female subtlety, slyness and fecundity. Summer idylls in the woods featured milk and wild strawberries, as well as *al fresco* sex, to show the sweetness and brevity of passing time.

On the edge, in the corners, darkness waited. Death loitered in many films—as a stranger, a crone, a ballet-master and, most memorably, as a cloaked and white-faced figure in “The Seventh Seal” of 1957, with whom the hero-knight plays a drawn-out game of chess. Mr Bergman admitted that death terrified him. And short of that he had “the demons” to contend with, anxiety, rage, regret and shame, which kept him company like “flocks of black birds”. Panic at his own dark aspects kept him alert and drove him on.

Critics wondered whether there was a general message in his films. Mr Bergman sometimes denied he had one. Yet he usually found a saving moment in the misery: a selfless communication, in word or gesture, between two human beings. At the end of “Wild Strawberries” the hero, an aged professor, is belatedly reconciled with his family and his past. As the scene was filmed, Mr Bergman noted, the old actor's face “shone with secretive light as if reflected from another reality”. That secretive light, or hidden love, was just what the director had been searching for.

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Overview

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America's GDP rose at an annualised rate of 3.4% in the second quarter, according to an initial estimate. Manufacturing had a less lively start to the third quarter. The Institute for Supply Management's activity index dropped to 53.8 in July from 56.0 in June. Inflation slowed to 1.9% in the year to June from 2% in the year to May, on the core personal consumption expenditures (PCE) index, a measure that excludes food and fuel and is closely watched by policymakers at the Fed.

Consumer prices in the **euro area** rose 1.8% in the year to July compared with 1.9% in the year to June. The unemployment rate was unchanged at 6.9%.

Japan's jobless rate fell to 3.7% in June, a nine-year low. Industrial production rose by 1.2% in the month, the first increase since February. The core consumer price index, which excludes volatile fresh food prices, fell by 0.1% in the year to June.

Demand in **Britain's** housing market has proved surprisingly resilient in the face of higher interest rates. The number of loans approved for purchasing houses was 114,000 in June, unchanged from May and only a little below the six-month average of 115,000.

In **South Korea** consumer prices rose by 2.5% in the year to July, the same rate as in June. Core inflation, which strips out food and energy prices, was unchanged at 2.3%.

India's central bank kept its benchmark interest rate at 7.75% on July 31st, though it raised the reserve ratio required from banks.

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Output, prices and jobs

Aug 2nd 2007
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2007†	2008†	latest	latest	year ago	2007†	rate‡, %
United States	+1.8 Q2	+3.4	+2.1	+2.7	+1.4 Jun	+2.7 Jun	+4.3	+2.7	4.5 Jun
Japan	+2.6 Q1	+3.3	+2.6	+2.3	+1.0 Jun	−0.2 Jun	+0.5	−0.1	3.7 Jun
China	+11.9 Q2	nil	+10.5	+9.6	+19.4 Jun	+4.4 Jun	+1.5	+3.0	9.5 2006
Britain	+3.0 Q2	+3.3	+2.8	+2.4	+0.6 May	+2.4 Jun**	+2.5	+2.4	5.4 May††
Canada	+2.0 Q1	+3.7	+2.5	+2.7	−0.1 May	+2.2 Jun	+2.4	+2.3	6.1 Jun
Euro area	+3.0 Q1	+2.4	+2.7	+2.3	+2.5 May	+1.8 Jul	+2.4	+2.0	6.9 Jun
Austria	+3.5 Q1	+3.6	+2.9	+2.6	+7.7 May	+2.0 Jun	+1.5	+1.8	4.3 Jun
Belgium	+2.9 Q2	+2.4	+2.6	+2.3	+1.8 May	+1.4 Jul	+1.6	+1.8	10.5 Jun‡‡
France	+1.9 Q1	+2.2	+2.0	+2.1	−0.3 May	+1.2 Jun	+1.9	+1.5	8.0 Jun
Germany	+3.6 Q1	+2.1	+2.8	+2.3	+4.6 May	+1.9 Jul	+1.9	+1.9	9.0 Jul
Greece	+4.6 Q1	na	+3.7	+3.2	+0.3 May	+2.6 Jun	+3.2	+2.6	8.4 Apr
Italy	+2.3 Q1	+1.1	+1.9	+1.7	+0.9 May	+1.6 Jul	+2.2	+1.8	6.2 Q1
Netherlands	+2.5 Q1	+3.6	+2.7	+2.6	+2.2 May	+1.7 Jun	+1.7	+1.8	4.6 Jun††
Spain	+4.1 Q1	+4.6	+3.7	+2.8	+2.4 May	+2.4 Jun	+3.9	+2.6	8.0 Jun
Czech Republic	+6.1 Q1	+6.1	+5.2	+4.0	+7.5 May	+2.5 Jun	+2.8	+2.5	6.3 Jun
Denmark	+2.3 Q1	+2.2	+2.2	+2.0	−4.3 May	+1.4 Jun	+2.1	+1.9	3.5 Jun
Hungary	+2.7 Q1	+2.4	+2.7	+3.0	+5.7 May	+8.6 Jun	+2.8	+7.3	7.0 Jun††
Norway	+2.8 Q1	+2.9	+2.7	+2.5	−3.9 May	+0.4 Jun	+2.1	+0.8	2.7 May††
Poland	+7.4 Q1	na	+6.3	+5.1	+5.6 Jun	+2.6 Jun	+0.8	+2.1	12.4 Jun‡‡
Russia	+7.9 Q1	na	+6.7	+6.2	+10.9 Jun	+8.5 Jun	+9.1	+7.8	6.7 Jun‡‡
Sweden	+3.0 Q1	+2.6	+3.5	+3.2	+3.6 May	+1.9 Jun	+1.5	+1.8	4.9 Jun‡‡
Switzerland	+2.4 Q1	+3.2	+2.4	+2.1	+7.3 Q1	+0.6 Jun	+1.6	+0.7	2.5 Jun‡‡
Turkey	+6.8 Q1	na	+6.0	+5.2	+5.2 May	+8.6 Jun	+10.1	+9.4	11.4 Q1‡‡
Australia	+3.8 Q1	+6.6	+3.5	+3.3	+5.5 Q1	+2.1 Q2	+4.0	+2.3	4.3 Jun
Hong Kong	+5.6 Q1	+2.0	+5.7	+5.0	−1.5 Q1	+1.3 Jun	+2.2	+2.0	4.2 Jun††
India	+9.1 Q1	na	+8.5	+8.0	+11.1 May	+6.6 May	+6.3	+5.9	7.6 2006
Indonesia	+6.0 Q1	na	+6.3	+6.2	+11.8 May	+6.1 Jul	+15.2	+5.8	9.8 Feb
Malaysia	+5.3 Q1	na	+5.9	+5.8	+3.1 May	+1.4 Jun	+3.9	+2.4	3.4 Q1
Pakistan	+6.6 2006§§	na	+6.4	+5.9	+7.1 May	+7.0 Jun	+7.6	+6.3	na
Singapore	+8.2 Q2	+12.8	+6.0	+4.5	−7.4 Jun	+1.3 Jun	+1.4	+0.9	2.4 Q2
South Korea	+4.9 Q2	+7.0	+4.5	+4.7	+7.6 Jun	+2.5 Jul	+2.4	+2.4	3.3 Jun
Taiwan	+4.2 Q1	na	+4.4	+4.6	+7.5 Jun	+0.1 Jun	+1.7	+1.2	3.9 Jun
Thailand	+4.3 Q1	+4.9	+4.2	+4.9	+6.3 May	+1.7 Jul	+4.4	+2.6	1.6 Mar
Argentina	+8.0 Q1	+4.1	+7.5	+5.5	+0.3 Jun	+8.8 Jun	+11.0	+9.3	9.8 Q1‡‡
Brazil	+4.3 Q1	+3.2	+4.3	+3.8	+4.9 May	+3.7 Jun	+4.0	+3.5	9.7 Jun‡‡
Chile	+5.8 Q1	na	+5.9	+5.3	+6.7 Jun	+3.2 Jun	+3.9	+3.0	6.9 Jun††††
Colombia	+8.1 Q1	+10.3	+6.4	+5.1	+11.9 May	+6.0 Jun	+3.9	+5.7	11.1 Jun‡‡
Mexico	+2.6 Q1	+0.6	+3.1	+3.5	+1.1 May	+4.0 Jun	+3.2	+3.9	3.3 Jun‡‡
Venezuela	+8.8 Q1	na	+5.9	+4.0	+10.0 Apr	+17.2 Jul	+13.5	+18.1	8.0 Q2‡‡
Egypt	+7.4 Q1	na	+7.0	+7.2	+10.5 2006	+8.5 Jun	+6.4	+8.4	9.0 Q4‡‡
Israel	+5.4 Q1	+6.3	+5.1	+4.5	+6.6 May	−0.7 Jun	+3.5	+0.3	7.7 Q1
Saudi Arabia	+4.3 2006§	na	+4.0	+5.7	na	+3.0 Jun	+1.8	+3.0	na
South Africa	+5.4 Q1	+4.7	+4.8	+5.2	+6.6 May	+7.0 Jun	+4.9	+5.8	25.5 Sep‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+9.8 Q1	+9.5	+9.4	+5.8	+6.2 May	+5.8 Jun	+4.3	+5.3	5.2 May
Finland	+5.4 Q1	+3.4	+3.6	+2.6	+0.3 Jun	+2.5 Jun	+1.7	+1.4	6.6 Jun
Iceland	−0.1 Q1	−3.6	+0.8	+1.8	+7.6 2006	+3.8 Jul	+8.4	+4.6	1.0 Jun‡‡
Ireland	+7.5 Q1	+20.1	+4.8	+3.4	−5.6 May	+4.9 Jun	+3.9	+4.2	4.6 Jun
Latvia	+10.7 Q1	na	+9.6	+7.5	+3.4 May	+8.8 Jun	+6.3	+7.9	5.9 May
Lithuania	+8.3 Q1	+6.1	+7.5	+6.7	na	+4.8 Jun	+3.7	+2.2	2.7 Jun
Luxembourg	+6.2 Q1	+6.6	+5.2	+4.3	+1.6 Apr	+2.0 Jun	+3.2	+2.4	4.1 May‡‡
New Zealand	+2.7 Q1	+2.5	+3.9	+3.1	nil Q1	+2.0 Q2	+4.0	+2.4	3.8 Q1
Peru	+8.3 May	na	+7.1	+5.5	+12.3 May	+2.2 Jul	+1.5	+1.2	7.6 Jun‡‡
Philippines	+6.9 Q1	+10.3	+6.0	+5.6	−7.1 May	+2.3 Jun	+6.7	+2.9	7.4 Q2‡‡
Portugal	+2.1 Q1	+3.2	+1.8	+2.1	+0.6 Jun	+2.4 Jun	+3.7	+2.3	8.4 Q1‡‡
Slovakia	+9.0 Q1	na	+8.0	+6.0	+17.4 May	+2.5 Jun	+4.6	+2.5	8.3 May
Slovenia	+7.2 Q1	na	+5.6	+4.2	+2.5 May	+3.8 Jul	+1.9	+2.6	7.7 May‡‡

*% change on previous quarter, annual rate. †*The Economist* poll. ‡National definitions. §Economist Intelligence Unit estimate/forecast. **RPI inflation rate 4.4% in Jun. ††Latest three months. ‡‡Not seasonally adjusted. §§Year ending June.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

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The Economist commodity-price index

Aug 2nd 2007
From The Economist print edition

The Economist commodity-price index

2000=100

	Jul 24th	Jul 31st*	% change on one month	% change on one year
Dollar index				
All items	207.6	204.0	+0.8	+16.0
Food	172.3	172.5	+2.2	+26.1
Industrials				
All	253.3	244.6	–0.4	+8.1
Nfa†	162.2	164.0	+3.0	+6.5
Metals	303.0	288.6	–1.4	+8.7
Sterling index				
All items	152.7	152.2	+0.0	+6.6
Euro index				
All items	138.9	137.8	+0.2	+8.0
Gold				
$ per oz	684.30	664.65	+1.8	+3.9
West Texas Intermediate				
$ per barrel	73.50	78.12	+9.4	+4.1

*Provisional †Non-food agriculturals.

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Productivity

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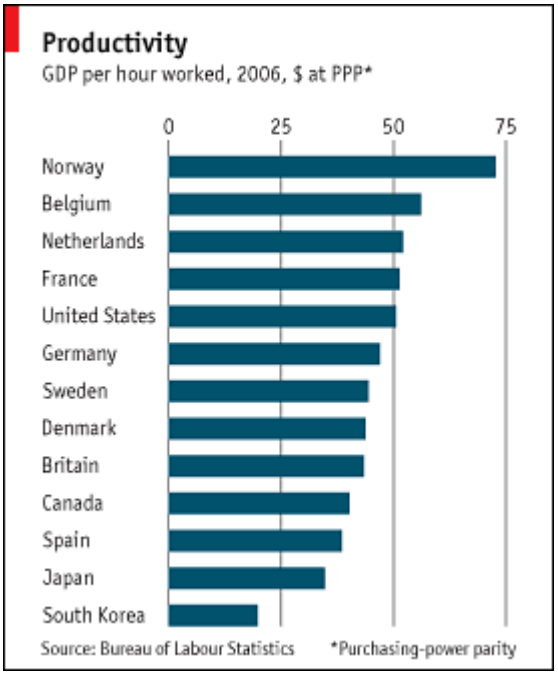

Americans are hard workers, but not necessarily the most productive workers, according to the Bureau of Labour Statistics. It has compared America's output per worker and output per hour with a clutch of other rich countries. It reckons that the average American worker produced about $90,000 of output in 2006, measured at purchasing-power parity. Only Norwegian workers, some of whom man oil-rigs, did better. But America's output per hour worked—just over $50—was less impressive. Employees in France, Belgium and the Netherlands were all able to squeeze more out of an hour of effort. In Norway, workers can churn out about $73-worth of goods and services in that time.

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Trade, exchange rates, budget balances and interest rates

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Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2007†‡	Currency units, per $ Aug 2nd	Currency units, per $ year ago	Budget balance % of GDP 2007‡	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	–827.1 May	–803.4 Q1	–6.0	–	–	–1.2	5.24	4.75
Japan	+91.4 May	+190.0 May	+3.4	119	115	–4.4	0.66	1.78
China	+229.1 Jun	+249.9 2006	+10.7	7.57	7.97	–0.7	3.19	4.28
Britain	–155.2 May	–93.0 Q1	–3.2	0.49	0.53	–2.7	6.00	5.21
Canada	+48.0 May	+18.5 Q1	+1.6	1.06	1.13	0.6	4.56	4.51
Euro area	+15.9 May	–1.0 May	nil	0.73	0.78	–0.9	4.26	4.34
Austria	+1.0 May	+13.2 Q1	+2.9	0.73	0.78	–0.8	4.26	4.44
Belgium	+18.2 May	+11.2 Mar	+2.1	0.73	0.78	nil	4.32	4.48
France	–36.1 May	–31.7 May	–1.2	0.73	0.78	–2.8	4.26	4.43
Germany	+234.6 May	+175.4 May	+4.9	0.73	0.78	0.3	4.26	4.34
Greece	–46.6 Apr	–33.6 May	–8.4	0.73	0.78	–2.4	4.26	4.65
Italy	–21.2 May	–48.4 Apr	–2.0	0.73	0.78	–2.6	4.26	4.63
Netherlands	+45.3 May	+16.8 Q1	+7.8	0.73	0.78	0.6	4.26	4.43
Spain	–119.6 May	–115.9 Apr	–8.6	0.73	0.78	2.0	4.26	4.46
Czech Republic	+2.8 May	–5.3 May	–4.1	20.5	22.2	–4.0	3.12	4.48
Denmark	+5.4 May	+5.3 May	+2.3	5.44	5.82	3.8	4.44	4.42
Hungary	–0.4 May	–6.2 Q1	–5.2	184	213	–6.5	7.60	6.60
Norway	+54.7 Jun	+57.3 Q1	+14.4	5.84	6.15	16.8	4.98	4.97
Poland	–7.5 May	–10.2 May	–2.7	2.78	3.07	–2.4	4.82	5.59
Russia	+128.3 May	+77.7 Q2	+6.8	25.6	26.8	3.0	10.00	6.06
Sweden	+19.5 Jun	+29.8 Q1	+6.9	6.77	7.18	2.4	3.47	4.28
Switzerland	+11.0 Jun	+102.1 Q1	+14.4	1.20	1.23	0.3	2.70	3.04
Turkey	–54.1 Jun	–31.0 May	–6.3	1.29	1.50	–2.8	18.64	6.65§
Australia	–9.9 May	–43.8 Q1	–5.4	1.17	1.31	1.3	6.62	5.91
Hong Kong	–18.9 May	+23.2 Q1	+10.1	7.83	7.77	1.8	4.37	4.38
India	–63.2 May	–9.6 Q1	–1.1	40.5	46.7	–3.3	4.45	8.19
Indonesia	+41.4 May	+10.3 Q1	+1.9	9,305	9,110	–1.6	8.19	7.14§
Malaysia	+28.5 May	+26.0 Q1	+11.0	3.47	3.68	–3.4	3.62	5.63§
Pakistan	–13.4 Jun	–6.8 Q1	–4.6	60.4	60.3	–3.8	9.56	8.82§
Singapore	+35.5 Jun	+38.1 Q1	+25.6	1.52	1.58	0.3	2.56	2.94
South Korea	+18.7 Jun	+5.2 Jun	+1.0	925	962	0.5	5.08	5.22
Taiwan	+13.8 Jun	+28.1 Q1	+6.1	32.9	32.9	–2.2	2.55	2.72
Thailand	+9.3 Jun	+11.1 Jun	+2.3	33.8	37.9	–1.9	3.55	4.19
Argentina	+11.2 Jun	+7.8 Q1	+3.2	3.13	3.07	1.2	12.13	na
Brazil	+47.4 Jun	+15.0 Jun	+0.8	1.88	2.19	–2.4	11.43	6.16§
Chile	+25.5 Jun	+7.1 Q1	+5.2	524	541	6.6	5.40	5.48§
Colombia	–0.9 Apr	–4.1 Q1	–3.2	1,973	2,426	–0.9	8.38	6.43§
Mexico	–11.8 Jun	–5.5 Q1	–0.9	11.0	11.0	0.1	7.19	7.75
Venezuela	+28.2 Q1	+23.8 Q1	+9.8	2,147	2,633	–4.1	11.10	6.55§
Egypt	–14.1 Q1	+3.3 Q1	+1.2	5.65	5.74	–5.6	6.98	5.70§
Israel	–7.8 Jun	+8.1 Q1	+3.5	4.33	4.40	–0.8	4.38	5.69
Saudi Arabia	+148.5 2006	+95.4 2006	+25.8	3.75	3.75	16.6	5.03	na
South Africa	–9.3 Jun	–16.6 Q1	–6.8	7.15	6.87	0.5	10.00	8.55
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Estonia	–4.1 May	–3.1 Apr	–16.0	11.4	12.2	1.7	4.73	na
Finland	+12.6 May	+12.6 May	+6.6	0.73	0.78	2.5	4.23	4.43
Iceland	–1.9 May	–4.0 Q1	–16.8	62.7	71.2	2.8	14.02	na
Ireland	+34.9 May	–10.6 Q1	–4.9	0.73	0.78	0.5	4.26	4.43
Latvia	–6.0 May	–5.6 May	–22.2	0.51	0.54	nil	5.83	na
Lithuania	–6.3 May	–3.9 May	–12.5	2.52	2.70	–0.5	5.05	na
Luxembourg	–5.3 Apr	+4.5 Q1	na	0.73	0.78	0.3	4.26	na
New Zealand	–4.2 Jun	–9.1 Q1	–10.7	1.31	1.61	4.8	7.10	6.50
Peru	+8.9 May	+2.7 Q1	+1.9	3.16	3.24	0.4	4.75	na
Philippines	–3.7 Apr	+5.7 Mar	+5.1	45.9	51.6	–1.1	6.69	na
Portugal	–23.0 Apr	–17.2 Apr	–7.9	0.73	0.78	–3.3	4.26	4.60
Slovakia	–2.0 May	–3.8 Mar	–4.3	24.5	29.7	–2.9	4.13	4.62
Slovenia	–2.3 May	–1.5 Apr	–2.2	0.73	0.78	–1.1	na	na

*Merchandise trade only. †*The Economist* poll. ‡Economist Intelligence Unit forecast. §Dollar-denominated bonds.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

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Markets

Aug 2nd 2007
From The Economist print edition

Markets

	Index Aug 1st	% change on one week	% change on Dec 29th 2006 in local currency	% change on Dec 29th 2006 in $ terms
United States (DJIA)	13,362.4	–3.1	+7.2	+7.2
United States (S&P 500)	1,465.8	–3.4	+3.3	+3.3
United States (NAScomp)	2,553.9	–3.6	+5.7	+5.7
Japan (Nikkei 225)	16,871.0	–5.5	–2.1	–1.6
Japan (Topix)	1,668.9	–4.9	–0.7	–0.2
China (SSEA)	4,510.8	–0.6	+60.2	+65.2
China (SSEB, $ terms)	311.4	+0.7	+132.1	+139.3
Britain (FTSE 100)	6,250.6	–3.2	+0.5	+4.2
Canada (S&P TSX)	13,654.7	–3.2	+5.8	+16.2
Euro area (FTSE Euro 100)	1,333.8	–2.8	+4.3	+8.2
Euro area (DJ STOXX 50)	4,237.1	–2.8	+2.8	+6.7
Austria (ATX)	4,617.9	–3.5	+3.5	+7.3
Belgium (Bel 20)	4,311.8	–3.9	–1.7	+1.9
France (CAC 40)	5,654.3	–3.1	+2.0	+5.8
Germany (DAX)*	7,473.9	–2.8	+13.3	+17.5
Greece (Athex Comp)	4,884.1	–3.6	+11.1	+15.3
Italy (S&P/MIB)	39,401.0	–2.7	–4.9	–1.4
Netherlands (AEX)	524.5	–4.1	+5.9	+9.8
Spain (Madrid SE)	1,608.9	–2.1	+3.5	+7.3
Czech Republic (PX)	1,747.8	–5.6	+10.0	+12.2
Denmark (OMXCB)	473.6	–2.7	+11.7	+16.0
Hungary (BUX)	28,854.5	–1.6	+16.1	+20.1
Norway (OSEAX)	561.3	–4.0	+11.7	+19.1
Poland (WIG)	62,297.3	–3.9	+23.6	+29.2
Russia (RTS, $ terms)	1,946.3	–5.0	–1.6	+1.3
Sweden (Aff.Gen)	387.5	–3.2	+6.1	+7.2
Switzerland (SMI)	8,885.0	–0.4	+1.1	+2.8
Turkey (ISE)	51,299.3	–6.4	+31.1	+43.7
Australia (All Ord.)	5,989.4	–6.1	+6.1	+15.2
Hong Kong (Hang Seng)	22,455.4	–3.9	+12.5	+11.7
India (BSE)	14,935.8	–4.9	+8.3	+18.5
Indonesia (JSX)	2,256.3	–5.8	+25.0	+20.8
Malaysia (KLSE)	1,339.5	–2.9	+22.2	+24.1
Pakistan (KSE)	13,738.9	+1.1	+36.8	+38.0
Singapore (STI)	3,431.7	–5.6	+14.9	+15.8
South Korea (KOSPI)	1,856.5	–7.4	+29.4	+30.1
Taiwan (TWI)	8,891.9	–8.7	+13.7	+12.6
Thailand (SET)	833.5	–5.7	+22.6	+31.0
Argentina (MERV)	2,177.2	–2.9	+4.1	+2.0
Brazil (BVSP)	54,233.0	–3.2	+21.9	+38.4
Chile (IGPA)	14,817.8	–0.5	+19.8	+21.5
Colombia (IGBC)	10,953.4	–2.3	–1.9	+11.4
Mexico (IPC)	30,048.4	–3.4	+13.6	+12.1
Venezuela (IBC)	42,230.4	+1.3	–19.2	+25.9
Egypt (Hermes)	71,805.6	–3.2	+17.2	+18.4
Israel (TA-100)	1,075.5	–6.1	+16.7	+13.6
Saudi Arabia (Tadawul)	7,538.9	–1.2	–5.0	–5.0
South Africa (JSE AS)	27,820.1	–4.4	+11.7	+10.1
Europe (FTSEurofirst 300)	1,526.3	–2.9	+2.9	+6.7
World, dev'd (MSCI)	1,556.3	–3.6	+4.9	+4.9
Emerging markets (MSCI)	1,074.6	–6.4	+17.7	+17.7
World, all (MSCI)	389.9	–3.9	+6.0	+6.0
World bonds (Citigroup)	676.1	+0.7	+2.7	+2.7
EMBI+ (JPMorgan)	406.0	–0.7	–0.3	–0.3
Hedge funds (HFRX)	1,337.4	–1.9	+4.8	+4.8
Volatility, US (VIX)	23.7	18.1	11.6	(levels)
CDSs, Eur (iTRAXX)†	57.7	+60.0	+147.5	+156.6
CDSs, N Am (CDX)†	75.4	+33.2	+125.4	+125.4
Carbon trading (EU ETS) €	0.10	–9.1	–98.4	–98.4

*Total return index. †Credit-default swap spreads, basis points. Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS;

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Broad money supply

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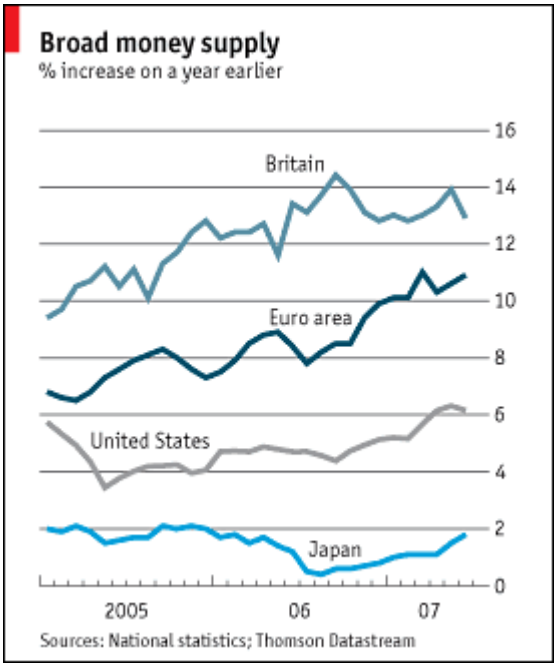

Broad measures of the money supply include notes and coins in circulation, the reserves that commercial banks hold at the central bank, and the deposits they in turn hold for their customers, including current accounts and less liquid savings instruments. Some central bankers keep a watchful eye on these measures lest too much money chase too few goods, resulting in inflation. The European Central Bank, for example, believes that monetary growth of no more than 4.5% is consistent with stable prices over the medium run. In fact, the quantity of money in the euro area increased by over 10% in the year to June. In Britain, which has higher interest rates, the money supply is nonetheless growing even faster.

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